



# ANNUAL REPORT



Waterstone Financial, Inc.

20  
19

# Dear Fellow Shareholder:



2019 was a record year for Waterstone Financial (WSBF) with record net income of \$35.9 million, 16.6% higher than our 2018 record earnings. This translates into a return on average assets (ROA) of 1.82% which is well above our peer group average of 1.30%. These earnings have allowed us to reward shareholders in 2019 with dividends of \$0.98 per share.

Waterstone Mortgage, WaterStone Bank's nationwide mortgage subsidiary, had a record volume in 2019, originating \$2.99 billion in residential mortgage loans. This led to a 92% increase in net income as compared to 2018.

The Community Banking segment had an efficiency ratio of 46.2% compared with our peers' 59.3%. We remain dedicated to being a low cost provider of our products and services which is necessary to succeed in a very competitive banking environment.

Asset quality was also at its best in 2019 as we ended with a non-performing assets to assets ratio of 0.39%. This ratio is in line with our peers who average 0.38%.

These record results are combined with a capital to asset ratio that is double the industry average. Our customers know they are banking with a strong institution that is positioned to weather any downturns in the economy. Our financial strength also enables us to invest in new products, facilities, and technology geared to the convenience and financial well-being of our customers. For example, in 2019 we added convenient branch locations in West Allis and

Oak Creek. And in 2020 we will be adding our first branch in Milwaukee, along with a new digital banking experience for our personal and business customers.

Waterstone strongly believes in giving back to the communities we serve. In 2019, we donated over \$800,000 to approximately 240 local schools and non-profit organizations. In addition, our dedicated employees volunteered over 700 hours of community service and actively served on over 50 non-profit Boards in the greater Milwaukee area. To honor our veterans, active military, and local first responders, we offer special products and services. We thank these community heroes for our freedom, safety, quality of life, and keeping our communities strong.

On behalf of all of us at Waterstone Financial, thank you for your continued support, and please accept our best wishes for a happy, healthy, and prosperous 2020.

Sincerely,

Doug Gordon  
President & CEO

## Highlights

Title sponsor for  
The Milwaukee  
Air & Water Show  
for the 3rd year  
in a row.

**\$800,000+**

DONATED TO 240+ LOCAL  
NON-PROFITS & SCHOOLS

**749+**

EMPLOYEE  
VOLUNTEER HOURS



April 9, 2020

Dear Fellow Shareholder,

We invite you to attend the Waterstone Financial, Inc. Annual Meeting of Shareholders, which will be held at WaterStone Bank SSB, 11200 W. Plank Ct., Wauwatosa, Wisconsin at 9:00 a.m., Central Time, on Tuesday, May 19, 2020.

We are furnishing proxy materials to our shareholders over the internet, as permitted by rules adopted by the Securities and Exchange Commission. You may read, print and download our 2019 Annual Report to Shareholders on Form 10-K and our Proxy Statement at [www.cstproxy.com/wsbonline/2020](http://www.cstproxy.com/wsbonline/2020). On April 9, 2020, we mailed our shareholders a notice containing instructions on how to access these materials and how to vote their shares online. The notice provides instructions on how you can request a paper copy of these materials by mail, by telephone or by e-mail. If you requested your materials via e-mail, the e-mail contains voting instructions and links to the materials on the internet.

You may vote your shares by internet, by telephone, by regular mail or in person at the Annual Meeting. Instructions regarding the various methods of voting are contained on the notice and on the Proxy Card.

The proxy materials describe the formal business to be transacted at the Annual Meeting. Included in the materials is our Annual Report on Form 10-K, which contains detailed information concerning our activities and operating performance.

On behalf of the board, we request that you vote your shares now, even if you currently plan to attend the Annual Meeting. This will not prevent you from voting in person, but will assure that your vote is counted.

Sincerely,

A handwritten signature in cursive script that reads "Doug Gordon".

**DOUGLAS S. GORDON**  
Chief Executive Officer

**WATERSTONE FINANCIAL, INC.**

**11200 W. Plank Ct.  
Wauwatosa, Wisconsin 53226  
(414) 761-1000**

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**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
TO BE HELD ON MAY 19, 2020**

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To the Shareholders of Waterstone Financial, Inc.:

The 2020 annual meeting of shareholders of Waterstone Financial, Inc. will be held on Tuesday, May 19, 2020, at 9:00 a.m., Central Time, at WaterStone Bank SSB, 11200 W. Plank Ct., Wauwatosa, Wisconsin for the following purposes:

- (1) Electing two directors to serve for a term expiring in 2023;
- (2) Approving the Waterstone Financial, Inc. 2020 Omnibus Incentive Plan;
- (3) Ratifying the selection of RSM US LLP as Waterstone Financial, Inc.'s independent registered public accounting firm;
- (4) Approving an advisory, non-binding resolution to approve the executive compensation described in the Proxy Statement;
- (5) Considering an advisory, non-binding proposal as to the frequency that shareholders will vote on our executive compensation; and
- (6) Transacting such other business as may properly come before the Annual Meeting or any adjournment or postponement thereof.

The board of directors has fixed March 25, 2020 as the record date for the determination of shareholders entitled to notice of and to vote at the annual meeting and any adjournment thereof. Only shareholders of record at the close of business on that date will be entitled to vote at the annual meeting and any adjournments thereof.

We call your attention to the Proxy Statement accompanying this notice for a more complete statement regarding the matters to be acted upon at the annual meeting. Please read it carefully.

We are monitoring the emerging public health impact of the coronavirus (COVID-19). The health and well-being of our employees, shareholders, directors, officers and other stakeholders are paramount. If public health developments warrant, we may change the date or location of the annual meeting, including the possibility that we may hold the annual meeting through a "virtual" or online method. Any such change will be announced as promptly as practicable, through a press release and a filing with the Securities and Exchange Commission, as well as any other notification required by state law.

By Order of the Board of Directors



William F. Bruss  
Executive Vice President and Secretary

Wauwatosa, Wisconsin  
April 9, 2020

## PROXY STATEMENT

WATERSTONE FINANCIAL, INC.  
11200 W. Plank Ct.  
Wauwatosa, Wisconsin 53226  
(414) 761-1000

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### SOLICITATION AND VOTING

This Proxy Statement and accompanying Proxy Card are furnished to the shareholders of Waterstone Financial, Inc. (“Waterstone Financial” or the “Company”) in connection with the solicitation of proxies by the Waterstone Financial board of directors for use at the annual meeting of shareholders on Tuesday, May 19, 2020, and at any adjournment of the meeting. The 2019 Annual Report on Form 10-K is enclosed with the Proxy Statement and contains business and financial information concerning us. Our proxy materials are being made available to shareholders on or about April 9, 2020.

*Record Date and Meeting Information.* The board of directors has fixed March 25, 2020 as the record date for the determination of shareholders entitled to notice of and to vote at the annual meeting and any adjournment thereof. Only holders of record of our common stock, the only class stock outstanding of Waterstone Financial outstanding, as of the close of business on the record date are entitled to notice of and to vote at the annual meeting. Each share of common stock is entitled to one vote. As of the record date, there were 26,438,256 shares of common stock issued and outstanding.

The board of directors of Waterstone Financial knows of no matters to be acted upon at the annual meeting other than as set forth in the notice attached to this Proxy Statement. If any other matters properly come before the annual meeting, or any adjournment thereof, it is the intention of the persons named in the proxy to vote such proxies in accordance with their best judgment on such matters.

*Voting Your Shares.* Any shareholder entitled to vote at the annual meeting may vote either in person, by a properly executed proxy or online as described in the notice to shareholders and the proxy card. Shares represented by properly executed proxies received by Waterstone Financial will be voted at the annual meeting, or any adjournment thereof, in accordance with the terms of such proxies, unless revoked. **Where no instructions are indicated, validly executed proxies will be voted “FOR” the proposals set forth in this Proxy Statement for consideration at the Annual Meeting.**

A shareholder may revoke a proxy at any time prior to the time when it is voted by filing a written notice of revocation with our corporate secretary at the address set forth above, by delivering a properly executed proxy bearing a later date, using the internet or telephone voting options explained on the Proxy Card, or by voting in person at the annual meeting. Attendance at the annual meeting will not in itself constitute revocation of a proxy. If you are a shareholder whose shares are not registered in your name, you will need appropriate documentation from your record holder in order to vote in person at the annual meeting.

*Shares in Employee Plans.* Any person who owns shares through an allocation to that person’s account under the WaterStone Bank SSB 2015 Amended and Restated Employee Stock Ownership Plan (the “ESOP”) or who has purchased shares in the Employer Stock Fund in the Waterstone Bank SSB 401(k) Plan (the “401(k) Plan”) will receive separate Vote Authorization Forms to instruct the ESOP Trustee and 401(k) Plan Trustee how to vote those shares. The deadline for returning instructions is May 12, 2020. The Trustee of both the ESOP and 401(k) Plan, Principal Trust Company, will vote shares allocated to a plan participant’s account in accordance with the participant’s instructions. Upon the direction of the plan administrator, the Trustee will vote the unallocated ESOP shares and any allocated ESOP shares for which no voting instructions are received in the same proportion as allocated shares for which it has received voting instructions. In addition, the Trustee will vote unvoted shares allocated to participants’ accounts in the 401(k) Plan in accordance with directions received from the plan administrator.

*Quorum and Required Vote.* A majority of the votes entitled to be cast by the shares entitled to vote, represented in person or by proxy, will constitute a quorum of shareholders at the annual meeting. Shares for which authority is withheld to vote for director nominees and broker non-votes (i.e., proxies from brokers or nominees indicating that such persons have not received instructions from the beneficial owners or other persons entitled to vote shares as to a matter with respect to which the brokers or nominees do not have discretionary power to vote) will be considered present for purposes of establishing a quorum. The inspector of election appointed by the board of directors will count the votes and ballots at the annual meeting.

As to Proposal 1, the election of directors, shareholders may vote “FOR” or “WITHHELD” as to each or all of the nominees. A plurality of the votes cast at the annual meeting by the holders of shares of common stock entitled to vote is required for the election of directors. In other words, the individuals who receive the largest number of votes are elected as directors up to the maximum number of directors in a class to be chosen at the annual meeting. With respect to the election of directors, any shares not voted, whether by withheld authority, broker non-vote or otherwise, will have no effect on the election of directors except to the extent that the failure to vote for an individual results in another individual receiving a comparatively larger number of votes.

As to Proposal 2, the approval of the Waterstone Financial, Inc. 2020 Omnibus Incentive Plan, by checking the appropriate box, a shareholder may: (i) vote FOR the approval; (ii) vote AGAINST the approval; or (iii) ABSTAIN from voting on such matter. The affirmative vote of a majority of the votes cast at the special meeting, without regard to either broker non-votes or shares as to which the “ABSTAIN” box has been selected on the proxy card, is required for the approval of this matter.

As to Proposal 3, the ratification of the independent registered public accounting firm, shareholders may vote “FOR” or “AGAINST,” or may “ABSTAIN” from voting on the matter. The affirmative vote of a majority of the votes cast at the Annual Meeting, without regard to either broker non-votes, or shares as to which the “ABSTAIN” box has been selected on the proxy card, is required to ratify RSM US LLP as our independent registered public accounting firm for the year ending December 31, 2020.

As to Proposal 4, the advisory, non-binding resolution to approve our executive compensation as described in this Proxy Statement, a shareholder may: (i) vote “FOR” the resolution; (ii) vote “AGAINST” the resolution; or (iii) “ABSTAIN” from voting on the resolution. The affirmative vote of a majority of the votes cast at the Annual Meeting, without regard to either broker non-votes, or shares as to which the “ABSTAIN” box has been selected on the proxy card, is required for the approval of this non-binding resolution. While this vote is required by law, it will neither be binding on Waterstone Financial, Inc. or the board of directors, nor will it create or imply any change in the fiduciary duties of, or impose any additional fiduciary duty on the members of the board of directors.

As to Proposal 5, the advisory, non-binding proposal with respect to the frequency that shareholders will vote on our executive compensation, a shareholder may select that shareholders: (i) consider the proposal every “ONE YEAR”; (ii) consider the proposal every “TWO YEARS”; (iii) consider the proposal every “THREE YEARS”; or (iv) “ABSTAIN” from voting on the proposal. Generally, approval of any matter presented to shareholders requires the affirmative vote of a majority of the votes cast. However, because this vote is advisory and non-binding, if none of the frequency options receive a majority of the votes cast, the option receiving the greatest number of votes will be considered the frequency recommended by Waterstone Financial’s shareholders. This vote will neither be binding on Waterstone Financial, Inc. or the board of directors, nor will it create or imply any change in the fiduciary duties of, or impose any additional fiduciary duty on Waterstone Financial, Inc. or the board of directors.

*Expenses and Solicitation.* We will pay all expenses incurred in connection with the solicitation of proxies. Proxies will be solicited principally by mail, but may also be solicited by our directors, officers and other employees in person or by telephone, facsimile or other means of communication. Those directors, officers and employees will receive no compensation therefor in addition to their regular compensation, but may be reimbursed for their related out-of-pocket expenses. Brokers, dealers, banks, or their nominees, who hold common stock on behalf of another will be asked to send proxy materials and related documents to the beneficial owners of such stock, and we will reimburse those persons for their reasonable expenses. In addition, we have entered into an agreement with Laurel Hill Advisory Group, LLC to assist in soliciting proxies for the annual meeting and we have agreed to pay them \$5,000, plus out-of-pocket expenses, for these services.

*Householding.* Some banks, brokers, broker-dealers and other similar organizations acting as nominee record holders may be participating in the practice of “householding” proxy materials. This means that only one copy of the notice of meeting and instructions on how to access the proxy materials and the 2019 Annual Report may have been sent to multiple stockholders in your household. If you would prefer to receive separate copies of these materials for other stockholders in your household, either now or in the future, please contact your bank, broker, broker-dealer or other similar organization serving as your nominee.

Upon written notice to Mark R. Gerke, Chief Financial Officer, Waterstone Financial, Inc., 11200 W. Plank Ct., Wauwatosa, Wisconsin 53226, or via telephone at (414) 761-1000, we will promptly provide separate copies of the 2019 Annual Report and/or this Proxy Statement. Stockholders sharing an address who are receiving multiple copies of this Proxy Statement and/or the 2019 Annual Report and who wish to receive a single copy of these materials in the future will need to contact their bank, broker, broker-dealer or other similar organization serving as their nominee to request that only a single copy of each document be mailed to all stockholders at the shared address in the future.

*Limitations on Voting.* The Company’s Articles of Incorporation provide that, subject to certain exceptions, record owners of the Company’s common stock that is beneficially owned by a person who beneficially owns in excess of 10% of the Company’s outstanding shares are not entitled to any vote any of the shares held in excess of the 10% limit.

#### **BENEFICIAL OWNERSHIP OF COMMON STOCK**

Persons and groups who beneficially own in excess of 5% of our shares of common stock are required to file certain reports with the Securities and Exchange Commission regarding such ownership pursuant to the Securities Exchange Act of 1934. The following table sets forth, as of March 25, 2020, the shares of our common stock beneficially owned by each person known to us who was the beneficial owner of more than 5% of the outstanding shares of our common stock, as well as by our directors, executive officers and directors and executive officers as a group.

Name of Beneficial Owner	Total Shares Beneficially Owned (1)	Percent of All Common Stock Outstanding
<u>5% or Greater Shareholders</u>		
Renaissance Technologies LLC Renaissance Technologies Holdings Corporation 800 Third Avenue New York, New York 10022	2,138,800 (2)	7.9%
Dimensional Fund Advisors LP Building One 6300 Bee Cave Road Austin, Texas 78746	2,053,631 (3)	7.6%
BlackRock, Inc. 55 East 52nd Street New York, New York 10055	1,911,109 (4)	7.0%
Delaware Charter Guarantee & Trust Company dba Principal Trust Company as Trustee for the 2010 Amended and Restated Waterstone Bank SSB Employee Stock Ownership Plan and the Waterstone Bank 401(K) Plan 1013 Centre Road Suite 300 Wilmington, Delaware 19805-1265	2,456,211 (5)	9.0%
<u>Directors and Executive Officers</u>		
Ellen S. Bartel.....	79,715	*
William F. Bruss.....	114,847	*
Thomas E. Dalum.....	187,627	*
Mark R. Gerke.....	72,224	*
Julie A. Glynn.....	9,069	*
Douglas S. Gordon.....	597,564	2.3%
Michael L. Hansen.....	328,913	1.2%
Patrick S. Lawton.....	261,062	*
Andy Peach.....	-	*
Kristine A. Rappé.....	103,818	*
Stephen J. Schmidt.....	132,578	*
All directors and executive officers as a group (11 persons) (6).....	3,362,710	12.7%

\* Less than 1%.

- (1) Unless otherwise noted, the specified persons have sole voting and dispositive power as to the shares. Number of shares identified as indirect beneficial ownership with shared voting and dispositive power: Mr. Bruss – 58,721; Mr. Dalum – 61,596; Mr. Gerke – 24,483; Mr. Gordon – 62,403; Mr. Hansen – 186,541; Mr. Lawton – 10,000; group – 1,887,417. Includes the following shares underlying options which are exercisable within 60 days of March 25, 2020: Bartel, Dalum, Hansen, Lawton, Rappé and Schmidt – 62,500 shares each; Mr. Bruss – 30,000; Mr. Gerke – 16,000; Ms. Glynn – 8,000; Mr. Gordon – 110,784; all directors and executive officers as a group – 539,499.
- (2) Based on a Schedule 13G/A filed by Renaissance Technologies LLC and Renaissance Technologies Holding Corporation with the Securities and Exchange Commission on February 13, 2020.
- (3) Based on a Schedule 13G/A filed by Dimensional Fund Advisors LP with the Securities and Exchange Commission on February 12, 2020.
- (4) Based on a Schedule 13G/A filed by BlackRock, Inc. with the Securities and Exchange Commission on February 6, 2020.
- (5) Based on a Schedule 13G/A filed by the Delaware Charter Guarantee & Trust Company dba Principal Trust Company as Trustee for the 2010 Amended and Restated WaterStone Bank SSB Employee Stock Ownership Plan and the WaterStone Bank SSB 401(k) Plan with the Securities and Exchange Commission on February 11, 2020. Such total includes shares purchased by plan participants in the Employer Stock Fund within the WaterStone Bank SSB 401(k) Plan, as well as allocated and unallocated shares held in trust within the WaterStone Bank SSB Employee Stock Ownership Plan.
- (6) The total for the group (but not any individual) includes 1,475,293 unallocated shares held in the Employee Stock Ownership Plan, as to which voting and dispositive power is shared. As administrator, WaterStone Bank SSB (“WaterStone



Bank” or the “Bank”) (through its ESOP Committee) may direct the ESOP Trustee to vote shares which have not yet been allocated to participants, provided that such vote is required to be made in the same proportion as allocated voted shares unless it is determined that to do so would not be in the best interest of participants and beneficiaries of the ESOP. Employees may vote the shares allocated to their accounts; the administrator will vote unvoted shares in its discretion. Allocated shares are included only if allocated to listed executive officers, in which case they are included in those individuals’ (and the group’s) beneficial ownership.

**PROPOSAL 1 – THE ELECTION OF DIRECTORS**

Waterstone Financial’s Board of Directors consists of seven members. Our bylaws provide that approximately one-third of the directors are to be elected annually. Directors of Waterstone Financial are generally elected to serve for a three-year period and until their respective successors have been duly elected and qualified. Directors Michael L. Hansen and Stephen J. Schmidt, whose terms expire at the annual meeting, are being nominated for re-election as directors, each for a term expiring at the 2023 annual meeting of shareholders. Shares represented by proxies will be voted FOR the election of the nominees unless otherwise specified by the executing shareholder. If a nominee declines or is unable to act as a director, proxies may be voted with discretionary authority for a substitute nominee designated by the board. Except as indicated herein, there are no arrangements or understandings between any nominee and any other person pursuant to which such nominee was selected.

The following details include for each of our nominees and directors: their age as of December 31, 2019; the year in which they first became a director of WaterStone Bank, the operating subsidiary of the Company; the year that their term expires; and their business experience for at least the past five years. The members of the Company’s Board of Directors are the same as the members of the Board of Directors of WaterStone Bank. None of the directors listed below currently serves as a director, or served as a director during the past five years, of a publicly-held entity (other than Waterstone Financial). The following also includes the particular experience, qualifications, attributes, or skills considered by the Nominating and Corporate Governance Committee that led the board of directors to conclude that such person should serve as a director of Waterstone Financial. The mailing address for each person listed is 11200 W. Plank Ct., Wauwatosa, Wisconsin 53226. The board of directors unanimously recommends that shareholders vote FOR the election of the director nominees listed below.

<u>Name and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>Director Since <sup>(1)</sup></u>
<i>Nominees for terms expiring in 2023</i>		
Michael L. Hansen, 68	Mr. Hansen is a business investor who currently holds significant ownership interests in Jacsten Holdings LLC and Mid-States Contracting, Inc. In addition to holding extensive entrepreneurial experience, Mr. Hansen is a C.P.A. with 13 years of audit and tax experience at an international public accounting firm. Mr. Hansen brings this experience to the board of directors and to the Audit Committee in particular. Mr. Hansen has a B.B.A. from the University of Notre Dame.	2003
Stephen J. Schmidt, 58	Mr. Schmidt is the President of Schmidt and Bartelt Funeral and Cremation Services. Mr. Schmidt has entrepreneurial experience and extensive community relationships throughout the communities served by WaterStone Bank. Mr. Schmidt has an Associate’s Degree from the New England Institute and a B.A. from the University of Wisconsin – Stevens Point.	2002

***Continuing Directors - Terms expiring in 2021***

- Douglas S. Gordon, 62 Mr. Gordon is the Chief Executive Officer and President of Waterstone Financial and WaterStone Bank since January 2007; President and Chief Operating Officer of WaterStone Bank from 2005 to 2007; real estate investor. Mr. Gordon brings extensive prior banking experience as an executive officer at M&I Bank and at Security Savings Bank. He has extensive firsthand knowledge and experience with our lending markets and our customers. Mr. Gordon has a B.A. from the University of Wisconsin – Parkside and an M.B.A. from Marquette University. 2005
- Patrick S. Lawton, 63 Mr. Lawton is the Managing Director of Fixed Income Capital Markets for Baird. Mr. Lawton is also a member of Baird’s board of directors. As a Baird Managing Director, Mr. Lawton brings his investment portfolio expertise to the board of directors. Mr. Lawton has a B.S.B.A. and an M.B.A. from Marquette University. 2000

***Continuing Directors - Terms expiring in 2022***

- Ellen S. Bartel, 65 Ms. Bartel is the former President of Divine Savior Holy Angels (DSHA) High School (Milwaukee, Wisconsin) since 1998 where she achieved significant improvements in DSHA’s curriculum, facilities, financial infrastructure, image, and reputation. Ms. Bartel balanced DSHA’s budget for 18 consecutive years, oversaw endowment growth from under \$1 million to over \$14 million, and developed recruitment strategies resulting in an incoming class wait list for 19 consecutive years. Prior to her employment at DSHA, Ms. Bartel held several positions at Alverno College (Milwaukee, Wisconsin) (1986 to 1997), with the most recent being Vice President of Institutional Advancement from 1994 to 1997. Ms. Bartel’s experience overseeing a large educational institution provides the board of directors with significant perspective on financial management and human resources matters. Ms. Bartel has a B.A. and an M.S.A. from the University of Notre Dame. 2013
- Thomas E. Dalum, 79 Mr. Dalum is the former Chairman and Chief Executive Officer of UELC, an equipment leasing company and of DUECO, an equipment manufacturer and distributor. Mr. Dalum brings an entrepreneurial background, a long-standing record of community involvement and public service plus more than 30 years of experience as a member of the WaterStone Bank board of directors. Mr. Dalum has a B.A. from the University of Notre Dame and an M.B.A. from Northwestern University. 1979
- Kristine A. Rappé, 63 Ms. Rappé is the former Senior Vice President and Chief Administrative Officer of WEC Energy Group (2004 to 2012). Her roles at WEC Energy Group also included Vice President and Corporate Secretary (2001 to 2004) and Vice President of Customer Services (1994 to 2001). In these roles, Ms. Rappé had responsibility for shared services including information technology, human resources, supply chain management, business continuity/corporate security, and the WEC Foundation. Ms. Rappé’s experience overseeing a large corporate entity provides the board of directors with significant perspective on financial management and human resources matters, and she has a long-standing history of community involvement and public service. Ms. Rappé has an M.A. from Northeastern University and a B.A. from the University of Wisconsin – Oshkosh. 2013

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(1) Indicates the date when director was first elected to the board of WaterStone Bank. Messrs. Lawton, Hansen, Dalum, Schmidt and Gordon became directors of Waterstone Financial’s predecessor federal corporation in 2005. Ms. Bartel and Ms. Rappé became directors of Waterstone Financial in 2014.

The following table details the composition of our board committees, each of which is composed entirely of independent directors.

Director	Audit Committee	Compensation Committee	Executive Committee	Nominating and Governance Committee
Ellen S. Bartel	X	X		Chair
Thomas E Dalum	X	Chair		
Michael L. Hansen	Chair		X	X
Patrick S. Lawton (Chair)		X	X	
Kristine A. Rappé,	X		Chair	
Stephen J. Schmidt		X	X	Chair

Information regarding our named executive officers (“Named Executive Officers” or “NEOs”) who are not directors of Waterstone Financial is set forth in the following table. Except as noted below, each of these individuals has held that position for at least the past five years.

<u>Name and Age</u>	<u>Offices and Positions with Waterstone Financial and WaterStone Bank</u>	<u>Executive Officer Since</u>
William F. Bruss, 49	Executive Vice President since 2015, Chief Operating Officer (appointed 2013), General Counsel and Secretary, Waterstone Financial and WaterStone Bank	2005
Mark R. Gerke, 44	Executive Vice President since January 2020, Chief Financial Officer since February 2016, Chief Accounting Officer (appointed 2014), Senior Vice President, Waterstone Financial and WaterStone Bank since 2014, Controller 2005 to February 2016	2016
Julie A. Glynn, 54	Senior Vice President and Director of Retail Banking of WaterStone Bank since March 2018, Senior Vice President - District Manager of Associated Bank since 2013	2018
Andy Peach, 54	President and Chief Executive Officer of Waterstone Mortgage Corporation since September 2019. Prior to his role with Waterstone Mortgage Corporation, Mr. Peach served in the following roles with Pacific Union Financial, LLP, Managing Director, Chief Production Officer - July 2017 through June 2018, Senior Executive Vice President, Institution Lending Group – February 2016 through June 2017, Executive Vice President Correspondent Lending – January 2014 through January 2016.	2019

### Board Meetings and Committees

The board of directors of Waterstone Financial met 12 times during the year ended December 31, 2019 on behalf of Waterstone Financial and an additional 13 times in their capacity as directors of WaterStone Bank. The board of directors consists of a majority of “independent directors” within the meaning of the NASDAQ corporate governance listing standards. The board of directors determines the independence of each director in accordance with NASDAQ Stock Market rules, which include all elements of independence as set forth in the listing requirements for NASDAQ securities. The board of directors has determined that Directors Bartel, Dalum, Hansen, Lawton, Rappé and Schmidt are “independent” directors within the meaning of such standards. In evaluating the independence of our independent directors, we found no transactions between us and our independent directors that are not required to be reported in this Proxy Statement and that had an impact on our determination as to the independence of our directors. Therefore, all members of the Audit, Compensation and Nominating Committees are “independent.” Additionally, the independent directors regularly meet without management or non-independent directors present. No member of the board of directors or any committee thereof attended fewer than 75% of the aggregate of: (i) the total number of meetings of the Board of Directors (held during the period for which each director has been a director); and (ii) the total number of meetings held by all committees of the board of directors on which he or she served (during the periods that he or she served).

**Audit Committee.** The audit committee of Waterstone Financial (the “Audit Committee”) met nine times during the year ended December 31, 2019. The board of directors has determined that each member of the Audit Committee meets not only the independence requirements applicable to the committee as prescribed by the NASDAQ corporate governance listing standards, but also by the Securities and Exchange Commission. On behalf of the Audit Committee, Mr. Hansen, its chair, also regularly consults with Waterstone Financial’s independent registered public accounting firm about Waterstone Financial’s periodic public financial disclosures. The board believes that all of the members of the Audit Committee have sufficient experience, knowledge and other personal qualifications to be “financially literate” and to be active, effective and contributing members of the Audit Committee. Mr. Hansen has been designated an “audit committee financial expert” pursuant to the Sarbanes-Oxley Act of 2002 and the Securities and Exchange Commission regulations. See also “Report of the Audit Committee” for other information pertaining to the Audit Committee.

**Compensation Committee.** The compensation committee of Waterstone Financial (the “Compensation Committee”) held 11 meetings during the year ended December 31, 2019. Each member of the Compensation Committee is considered independent as defined in the NASDAQ corporate governance listing standards. The Compensation Committee has the responsibility for and authority to either establish or recommend to the board: compensation policies and plans; salaries, bonuses and benefits for all officers; salary and benefit levels for employees; determinations with respect to stock options and restricted stock awards; and other personnel policies and procedures. The Compensation Committee has the authority to delegate the development, implementation and execution of benefit plans to management. See also “Compensation Discussion and Analysis” and “Compensation Committee Interlocks and Insider Participation” for other information pertaining to the Compensation Committee.

**Nominating and Corporate Governance Committee.** The nominating and corporate governance committee (“Nominating Committee”) of Waterstone Financial held one meeting during the year ended December 31, 2019. Each member of the Nominating Committee is considered “independent” as defined in the NASDAQ corporate governance listing standards.

The functions of the Nominating Committee include the following:

- to lead the search for individuals qualified to become members of the board of directors and to select director nominees to be presented for shareholder approval;
- to review and monitor compliance with the requirements for board independence;
- to review the committee structure and make recommendations to the board of directors regarding committee membership; and
- to develop and recommend to the board of directors for its approval a set of corporate governance guidelines.

The Nominating Committee identifies nominees by first evaluating the current members of the board of directors willing to continue in service. Current members of the board of directors with skills and experience that are relevant to our business and who are willing to continue in service are first considered for re-nomination, balancing the value of continuity of service by existing members of the board of directors with that of obtaining new perspectives. If any member of the board of directors does not wish to continue in service, or if the committee or the board decides not to re-nominate a member for re-election, or if the size of the board of directors is increased, the Nominating Committee would solicit suggestions for director candidates from all directors.

Qualifications of director candidates are described in the Appendix to the Nominating and Corporate Governance Committee Charter, which can be found on our website, at [www.wsbonline.com](http://www.wsbonline.com), on the “Investor Relations” link under the “About” tab, then “Corporate Overview” and “Governance Documents.” Factors considered include strength of character, honesty and integrity, an inquiring and independent mind, judgment, skill, diversity, education, experience with businesses and other organizations, the interplay of the candidates’ experience with the experience of other board members and the extent to which the candidate would be a desirable addition to the board and its committees. Nominees must have a background which demonstrates an understanding of business and financial affairs and the complexities of a business organization. Although a career in business is not essential, the nominee should have a proven record of competence and accomplishments through leadership in industry, education, the professions or government. Areas of core competency that should be represented on the board as a whole include

accounting and finance, business judgment, management, crisis response, industry knowledge, leadership and strategic vision.

The Nominating Committee will also take into account whether a candidate satisfies the criteria for “independence” under the NASDAQ corporate governance listing standards and, if a nominee is sought for service on the Audit Committee, the financial and accounting expertise of a candidate, including whether an individual qualifies as an “audit committee financial expert.”

The Nominating Committee will consider proposed nominees whose names are submitted to it by shareholders, and it does not intend to evaluate proposed nominees differently depending upon who has made the proposal. Shareholders can submit the names of qualified candidates for director by writing to our Corporate Secretary at 11200 W. Plank Ct., Wauwatosa, Wisconsin 53226. The Corporate Secretary must receive a submission not earlier than the 90th day nor later than the 80th day prior to date of the annual meeting; provided, however, that in the event that less than 90 days’ notice or prior public disclosure of the date of the annual meeting is provided to shareholders, then, to be timely, notice by the stockholder must be so received not later than the tenth day following the day on which public announcement of the date of such meeting is first made. The submission must include the following information:

- a statement that the writer is a shareholder and is proposing a candidate for consideration by the Nominating Committee;
- the name and address of the shareholder as they appear on our books and number of shares of our common stock that are owned beneficially by such shareholder (if the shareholder is not a holder of record, appropriate evidence of the shareholder’s ownership will be required);
- the name, address and contact information for the candidate, and the number of shares of common stock that are owned by the candidate (if the candidate is not a holder of record, appropriate evidence of the shareholder’s ownership should be provided);
- a statement of the candidate’s business and educational experience;
- such other information regarding the candidate as would be required to be included in the Proxy Statement pursuant to Securities and Exchange Commission Regulation 14A;
- a statement detailing any relationship between us and the candidate;
- a statement detailing any relationship between the candidate and any of our customers, suppliers or competitors;
- detailed information about any relationship or understanding between the proposing shareholder and the candidate; and
- a statement that the candidate is willing to be considered and willing to serve as a director if nominated and elected.

A nomination submitted by a shareholder for presentation at an annual meeting of shareholders will also need to comply with any additional procedural and informational requirements we may adopt in the future, including those set forth in our Bylaws and in the “Shareholder Proposals and Notices” section of this Proxy Statement.

Waterstone Financial has adopted charters for the Audit, Compensation and Nominating Committees. We will continue to respond to and comply with Securities and Exchange Commission and NASDAQ Stock Market requirements relating to board committees. Copies of the charters for our Audit, Compensation and Nominating Committees (including director selection criteria) and other corporate governance documents can be found on our website, at [www.wsbonline.com](http://www.wsbonline.com), on the “Investor Relations” link under the “About” tab, then “Corporate Overview” and “Governance Documents.” If any of those documents are changed, or related documents adopted, those changes and new documents will be posted on our corporate website at that address.

### **Other Board and Corporate Governance Matters**

***Board Leadership Structure and Risk Oversight Role.*** The role of chairman of the board of directors and chief executive officer of the Company are not currently held by the same person. The chairman of the board has

never been an officer or employee of the Company or WaterStone Bank. The foregoing structure is not mandated by any provision of law or our Articles of Incorporation or Bylaws, but the board of directors currently believes that this structure provides for an appropriate balance of authority between management and the board. The board of directors reserves the right to establish a different structure in the future.

The board of directors of the Company, all of the members of which are also members of the board of directors of WaterStone Bank, is actively involved in the Company's and Bank's risk oversight activities, through the work of numerous committees of the Company and Bank, and the policy approval function of the board of directors of WaterStone Bank.

***Communications Between Shareholders and the Board.*** A shareholder who wants to communicate with the board of directors or with any individual director can write to our Corporate Secretary at 11200 W. Plank Ct., Wauwatosa, Wisconsin 53226, Attention: Board Administration. The letter should indicate that the author is a shareholder and if shares are not held of record, should include appropriate evidence of stock ownership. Depending on the subject matter, management will:

- forward the communication to the director or directors to whom it is addressed;
- attempt to handle the inquiry directly, i.e. where it is a request for information about us or it is a stock-related matter; or
- not forward the communication if it is primarily commercial in nature, relates to an improper or irrelevant topic, or is unduly hostile, threatening, illegal or otherwise inappropriate.

At each board meeting, management shall present a summary of all communications received since the last meeting that were not forwarded and make those communications available to the directors.

***Director Attendance at Annual Shareholders' Meeting.*** Although we do not have a formal policy regarding director attendance at the annual meeting, we encourage all of our directors to attend. Last year, six of the seven directors serving at that time were present at the annual meeting.

***Code of Business Conduct and Ethics.*** Waterstone Financial has adopted a code of business conduct and ethics that reflects current circumstances and Securities and Exchange Commission and NASDAQ definitions for such codes. The code of business conduct and ethics covers us, WaterStone Bank and other subsidiaries. Among other things, the code of business conduct and ethics includes provisions regarding honest and ethical conduct, conflicts of interest, full and fair disclosure, compliance with law, and reporting of and sanctions for violations. The code applies to all directors, officers and employees of Waterstone Financial and subsidiaries. We have posted a copy of the code of business conduct and ethics on our website, at [www.wsbonline.com](http://www.wsbonline.com), on the "Investor Relations" link under the "About" tab, then "Corporate Overview" and "Governance Documents." As further matters are documented, or if those documents (including the code of business conduct and ethics) are changed, waivers from the code of business conduct and ethics are granted, or new procedures are adopted, those new documents, changes and/or waivers will be posted on the corporate website at that address.

## **PROPOSAL 2—APPROVAL OF THE WATERSTONE FINANCIAL, INC. 2020 OMNIBUS INCENTIVE PLAN**

The Board of Directors has adopted, subject to shareholder approval, the Waterstone Financial, Inc. 2020 Omnibus Incentive Plan (the "2020 Plan") to give the Company a competitive advantage in attracting, retaining, and motivating officers, employees, directors, and consultants and to provide the Company and its subsidiaries and affiliates with a compensation plan providing incentives for future performance of services directly linked to the profitability of the Company's businesses and increases in Company shareholder value.

Equity-based compensation is an important component of compensation at our competitors. The adoption of the 2020 Plan will aid the Company in its efforts to attract and retain key employees and help to align the interests of the Company's employees with those of its shareholders by providing employees an incentive to devote their best efforts to pursue and sustain long-term Company performance and enhance the value of the Company. To this end,

the Board believes it is desirable to adopt an equity plan that is intended to be consistent with corporate governance best practices and provides the flexibility to grant various types of equity awards, enabling the Company to react appropriately to a changing competitive and regulatory environment while being mindful of the impact to shareholders. In its competitive marketplace, the Company believes it is important to be able to employ a wide range of incentive compensation vehicles to attract and retain top talent.

***Promotion of Best Practices.*** The Company is committed to sound corporate governance and effective risk-based management of equity compensation. The Company's commitment is reflected in the 2020 Plan by various features.

- ***No Discounted Stock Options or Stock Appreciation Rights.*** Stock options and stock appreciation rights may not be granted with exercise prices lower than the fair market value of the underlying shares on the date of grant.
- ***No "Repricing" without Shareholder Approval.*** The Company may not, without the approval of shareholders, (i) reduce the exercise price of an outstanding stock option or the grant price of an outstanding stock appreciation right or (ii) cancel and re-grant an outstanding option or stock appreciation right or exchange such option or stock appreciation right for either cash or a new award with a lower (or no) exercise price when the exercise price of such option or stock appreciation right is above the fair market value of a share of common stock.
- ***No "Evergreen" Provision.*** There is no "evergreen" feature pursuant to which the shares available for issuance under the 2020 Plan can be automatically replenished.
- ***Minimum Vesting.*** The 2020 Plan provides that awards in respect of 95% of the shares authorized under the 2020 Plan may not have a scheduled vesting period of less than one year from the grant date.
- ***"Double Trigger" Vesting.*** Awards issued under the 2020 Plan that are assumed by an acquirer will not vest solely upon a change in control.
- ***No Dividends on Unvested Awards.*** The 2020 Plan prohibits the payment of dividends or dividend equivalents on awards that do not vest.
- ***No Transferability.*** Awards generally may not be transferred, except by will or the laws of descent and distribution, unless approved by the Company.
- ***No Share "Recycling".*** Shares issued in respect of awards that have been settled or exercised will not be available for future grants. Shares withheld by or delivered to the Company to satisfy the exercise price of stock options or tax withholding obligations will also be considered issued under the 2020 Plan and not available for future grants.
- ***Clawback.*** The 2020 Plan provides that performance-based awards granted thereunder shall be subject to the Company's clawback.

***Determination of Shares Subject to the 2020 Plan.*** The aggregate number of shares of common stock available for issuance under the 2020 Plan is 1,250,000. Following adoption of the 2020 Plan, no shares will be available for the grant of additional awards under the Company's prior plans (Waterstone Financial, Inc. 2015 Equity Incentive Plan and Wauwatosa Holdings, In. 2006 Equity Incentive Plan). In determining the number of shares to be available under the 2020 Plan, the Compensation Committee considered data prepared by its independent compensation consultant, the number of directors, officers and employees eligible for awards and the Company's pay for performance philosophy. During the three years ending December 31, 2019, we granted stock options to acquire 130,000 shares of our common stock and did not grant any full value awards. Based on the Company's expectations as to compensation design and equity grant practices, the Compensation Committee believes that the 1,250,000 shares of common stock available under the 2020 Plan would be sufficient to cover awards for at least the next three years. Awards granted under the 2020 Plan are discretionary, so it is not possible to predict the number of shares of common stock that would be granted or who would receive awards thereunder. The Compensation Committee and Board intend to consider the Company's equity expenditures in a manner that effectively attracts, retains, and motivates individuals to achieve long-term value creation in line with the interests of the Company's shareholders.

## Summary of the 2020 Plan

*Description of the 2020 Plan.* The following is a general description of the material features of the 2020 Plan. This description is qualified in its entirety by reference to the full text of the 2020 Plan, a copy of which is attached to this Proxy Statement as Appendix A. Shareholders are encouraged to read the 2020 Plan in its entirety.

*Eligibility for Awards.* Awards may be granted under the 2020 Plan to directors, officers, employees and consultants of the Company and any of its subsidiaries. As of the date of this Proxy Statement, there were six non-employee directors and approximately 50 officers and employees eligible to participate in the 2020 Plan. Awards may also be granted to prospective directors, officers, employees and consultants who have accepted offers of employment or consultancy from the Company or any of its subsidiaries.

*Administration.* The 2020 Plan will be administered by the Board directly or, if the Board elects, the Compensation Committee of the Board or such other committee of the Board as the Board may from time to time designate. Subject to applicable law, the Compensation Committee may allocate all or any portion of its responsibilities and powers to any one or more of its members or persons selected by it. Subject to the terms and conditions of the 2020 Plan, the Compensation Committee will have authority under the 2020 Plan to select individuals to whom awards may be granted, to determine the type of award as well as the number of shares of common stock to be covered by each award, and to determine the terms and conditions of any such awards.

*Minimum Vesting Period.* Except for awards granted with respect to a maximum of five percent of the authorized shares under the 2020 Plan, award agreements will not provide for a scheduled vesting period of less than one year from the grant date.

*Shares Available; Limitations on Awards.* The aggregate number of shares of Company common stock available for issuance under the 2020 Plan is 1,250,000. The maximum number of shares that may be granted pursuant to full value awards is 500,000 shares and the maximum number of shares that may be granted pursuant to stock options intended to be incentive stock options is 750,000 shares. If the tax withholding obligations relating to any award under the 2020 Plan or the exercise price of any stock option or stock appreciation right is satisfied by delivering shares of common stock (by either actual delivery or by attestation) or by withholding shares, such shares of common stock will be deemed to have been granted under the 2020 Plan.

In each calendar year, the awards granted under the 2020 Plan to a participant who is not a non-employee director may not exceed (a) 50,000 shares covering stock options and stock appreciation rights, and (b) 35,000 shares covering full-value awards.

*Adjustments.* The 2020 Plan provides that in the event of certain extraordinary corporate transactions or events affecting the Company, the Compensation Committee will or may make such substitutions or adjustments as it deems appropriate and equitable to (a) the aggregate number and kind of shares or other securities reserved for issuance and delivery under the 2020 Plan, (b) the various maximum limitations set forth in the 2020 Plan, (c) the number and kind of shares or other securities subject to outstanding awards, and (d) the exercise price of outstanding options and stock appreciation rights. In the event of a corporate transaction such as a merger or consolidation, such adjustments may include the cancellation of outstanding awards in exchange for cash or other property or the substitution of other property for the shares subject to outstanding awards.

*Stock Options and Stock Appreciation Rights.* The 2020 Plan provides for the grant of stock options (both incentive stock options and nonqualified stock options) and stock appreciation rights. Stock option awards entitle a participant to purchase shares of common stock during the option term at a fixed price that is set by the Compensation Committee on the date of grant. Stock appreciation rights entitle a participant to receive shares of common stock (or cash) on exercise with a value equal to the excess of the fair market value of a share of common stock on the date of exercise over the grant price of the stock appreciation right.

Each grant of stock options or stock appreciation rights under the 2020 Plan will be evidenced by an award agreement that specifies the exercise price, the duration of the award, the number of shares to which the award pertains,



and such additional limitations, terms, and conditions as the Compensation Committee may determine, including, in the case of stock options, whether the options are intended to be incentive stock options or nonqualified stock options. The 2020 Plan provides that the exercise price of stock options and stock appreciation rights will be determined by the Compensation Committee, but may not be less than 100% of the fair market value of the stock underlying the stock options or stock appreciation rights on the date of grant. The term of stock options and stock appreciation rights will be determined by the Compensation Committee, but may not exceed ten years from the date of grant. The Compensation Committee will determine the vesting and exercise schedule of stock options and stock appreciation rights, including the treatment upon termination of service.

*Restricted Stock.* Restricted stock may be granted under the 2020 Plan with such restrictions as the Compensation Committee may designate. The Compensation Committee may provide at the time of grant that the vesting of restricted stock will be contingent upon the achievement of applicable performance goals and/or continued service. Except for these restrictions and any others imposed under the 2020 Plan or by the Compensation Committee, upon the grant of restricted stock under the 2020 Plan, the recipient will have rights of a shareholder with respect to the restricted stock, including the right to vote the restricted stock; however, the Compensation Committee will determine if the recipient will be entitled to receive cash or stock dividends paid, which will be subject to the vesting of the underlying award.

*Restricted Stock Units.* The Compensation Committee may grant restricted stock units payable in cash, shares of common stock, or both, conditioned upon continued service and/or the attainment of applicable performance goals determined by the Compensation Committee. The Company is not required to set aside a fund for the payment of any restricted stock units. The award agreement for restricted stock units will specify whether and on what terms the participant will be entitled to receive dividend equivalents with respect to the restricted stock units, which will be subject to the vesting of the underlying award.

*Other Stock Based Awards.* The Compensation Committee may grant awards that are denominated or payable in, valued by reference to, or otherwise based on or related to, shares of our common stock, on such terms and conditions as the Compensation Committee determines. Such awards might involve the transfer of shares of common stock to participants, either at the time of grant or thereafter, or payment in cash or otherwise of amounts based on the value of shares, be subject to performance-based and/or service-based conditions, be in the form of phantom stock, restricted stock, restricted stock units, performance shares, deferred share units or share-denominated performance units, or other awards denominated in, or with a value determined by reference to, a number of shares of common stock.

*Performance Awards.* Under the 2020 Plan, the Compensation Committee may determine that the grant, vesting, or settlement of an award granted under the 2020 Plan will be subject to the attainment of one or more performance goals. The performance measures to be achieved as a condition of payment or settlement of a performance may be based on one or more business criteria for the Company on a consolidated basis, and/or for specified subsidiaries or business units of the Company, in absolute terms or relative to the performance of one or more other companies. The performance goals may be based on a number of criteria, including those specified in the 2020 Plan.

*Clawback Policy.* Performance-based awards granted under the 2020 Plan will be subject to the Company's clawback policy.

*Effect of Change in Control.* The 2020 Plan provides that, unless otherwise set forth in an award agreement, in the event of a change in control (as defined in the 2020 Plan) and to the extent an award is not replaced by a replacement award (as described below), (a) each then-outstanding stock option and stock appreciation right will become fully vested and exercisable, and each other award (other than a performance-based award) will vest, be free of restrictions, and be deemed to be earned and payable; and (b) each then-outstanding performance-based award will be deemed to be earned and payable, with all applicable performance goals deemed achieved at the greater of (i) the applicable target level and (ii) actual performance, as determined by the Compensation Committee, through the latest date practicable preceding the date of the change in control.

A replacement award is an award that is the same type as the replaced award with a value equal to the value of the replaced award as of the date of the change in control, as determined by the Compensation Committee and if

the underlying replaced award was an equity-based award, the replacement award relates to publicly traded equity securities of the Company or the entity surviving the Company following the change in control and contains terms relating to vesting that are substantially identical to those of the replaced award and other terms and conditions are not less favorable than the terms and conditions of the replaced award.

Unless otherwise determined by the Compensation Committee and set forth in the applicable award agreement, upon termination of service within 24 months following a change in control (other than for cause), (i) all replacement awards held will vest in full, be free of restrictions, and be deemed to be earned in full (with respect to performance goals, unless otherwise agreed in connection with the change in control, at the greater of (x) the applicable target level and (y) actual performance, as determined by the Compensation Committee, through the latest date practicable preceding the termination of service) and (ii) any outstanding stock option or stock appreciation right as of the date of the change in control that remains outstanding as of the date of such termination of service may thereafter be exercised until the expiration of its stated full term.

*Amendment and Termination of the 2020 Plan.* The Board or the Compensation Committee may amend, alter or discontinue the 2020 Plan or an award granted thereunder, but no amendment, alteration or discontinuation shall be made that would materially impair the rights of the participant with respect to a previously granted award without such participant's consent, except such an amendment made to comply with applicable law, including Section 409A of the Internal Revenue Code ("Code"), applicable exchange listing standards or accounting rules. In addition, no amendment shall be made without the approval of the Company's shareholders to the extent such approval is required by applicable law or the listing standards of the applicable exchange. The 2020 Plan will become effective on the date that it is approved by the Company's shareholders and, if not terminated earlier, will expire on the tenth anniversary thereof.

*Federal Income Tax Consequences Relating to Equity Awards Granted under the 2020 Plan.* The following discussion summarizes certain federal income tax consequences of the issuance, receipt, and exercises of stock options and the granting and vesting of restricted stock and restricted stock units, in each case under the 2020 Plan. The summary does not purport to cover federal employment tax or other federal tax consequences that may be associated with the 2020 Plan, nor does it cover state, local, or non-U.S. taxes. Interested parties should consult their own advisers as to specific tax consequences, including the application and effect of foreign, state and local tax laws.

Nonqualified Options. In general, in the case of a nonqualified stock option, the participant has no taxable income at the time of grant but realizes income in connection with exercise of the option in an amount equal to the excess (at the time of exercise) of the fair market value of the shares acquired upon exercise over the exercise price. A corresponding deduction is available to the Company. Any gain or loss recognized upon a subsequent sale or exchange of the shares is treated as capital gain or loss for which the Company is not entitled to a deduction.

Incentive Stock Options. In general, a participant realizes no taxable income upon the grant or exercise of an incentive stock option. The exercise of an incentive stock option, however, may result in an alternative minimum tax liability to the participant. With certain exceptions, a disposition of shares purchased under an incentive stock option within two years from the date of grant or within one year after exercise produces ordinary income to the participant (and a deduction for the Company) equal to the value of the shares at the time of exercise less the exercise price. Any additional gain recognized in the disposition is treated as a capital gain for which the Company is not entitled to a deduction. If the participant does not dispose of the shares until after the expiration of these one- and two-year holding periods, any gain or loss recognized upon a subsequent sale is treated as a long-term capital gain or loss for which the Company is not entitled to a deduction.

Restricted Stock. Unless a participant makes an election to accelerate recognition of the income to the date of grant as described below, the participant will not recognize income, and the Company will not be allowed a tax deduction, at the time a restricted stock award is granted. When the restrictions lapse, the participant will recognize ordinary income equal to the fair market value of the common stock as of that date, less any amount paid for the stock, and the Company will be allowed a corresponding tax deduction at that time. If the participant files an election under Section 83(b) of the Code within 30 days after the date of grant of the restricted stock, the participant will recognize ordinary income as of the date of grant equal to the fair market value of the common stock as of that date, less any amount the participant paid for the common stock, and the Company will be allowed a corresponding tax deduction at that time. Any future appreciation in the common stock will be taxable to the participant at capital gains rates. If,

however, the restricted stock award is later forfeited, the participant will not be able to recover the tax previously paid pursuant to his or her Section 83(b) election.

Restricted Stock Units. A participant does not recognize income, and the Company will not be allowed a tax deduction, at the time a restricted stock unit is granted. When the restricted stock units vest and are settled for cash or stock, the participant generally will be required to recognize as income an amount equal to the fair market value of the shares on the date of vesting. Any gain or loss recognized upon a subsequent sale or exchange of the stock (if settled in stock) is treated as capital gain or loss for which we are not entitled to a deduction.

Code Section 162(m). In general, Code Section 162(m) limits the Company's compensation deduction to \$1,000,000 paid in any tax year to any "covered employee" as defined under Section 162(m). Code Section 162(m) may result in all or a portion of the awards granted under the 2020 Plan to "covered employees" failing to be deductible to the Company for federal income tax purposes.

Code Section 280G. Awards that are granted, accelerated or enhanced upon the occurrence of a change in control may give rise, in whole or in part, to "excess parachute payments" within the meaning of Code Section 280G and, to such extent, will be non-deductible by the Company and subject to a 20% excise tax payable by the participant.

Code Section 409A. Code Section 409A applies to compensation that individuals earn in one year but that is not paid until a future year. This is referred to as nonqualified deferred compensation. If deferred compensation covered by Code Section 409A meets the requirements of Code Section 409A, then Code Section 409A has no effect on the individual's taxes. If a deferred compensation arrangement does not meet the requirements of Code Section 409A, the compensation is subject to accelerated taxation in the year in which such compensation is no longer subject to a substantial risk of forfeiture and certain additional taxes, interest and penalties, including a 20% additional income tax. The 2020 Plan permits the grant of various types of incentive awards, which may or may not be subject to Code Section 409A. If an award that is subject to Code Section 409A does not satisfy the requirements of Code Section 409A, the taxable event for such award could apply earlier than intended and could result in the imposition of additional taxes and penalties on the participant.

*New Plan Benefits.* Grants of awards under the 2020 Plan will be subject to the discretion of the Compensation Committee. Accordingly, it is not possible to determine the amounts that will or may be received by employees, non-employee directors or other eligible participants in the 2020 Plan.

*Required Shareholder Vote.* The affirmative vote of a majority of the votes cast at the special meeting, without regard to either broker non-votes or shares as to which the "ABSTAIN" box has been selected on the proxy card, is required for the approval of the 2020 Plan.

**The Board of Directors recommends a vote "FOR" the approval of the 2020 Omnibus Incentive Plan.**

#### **REPORT OF THE AUDIT COMMITTEE**

The Audit Committee of the Waterstone Financial board of directors was created in accordance with Section 3(a)(58)(a) of the Exchange Act. The Audit Committee's functions include meeting with our independent registered public accounting firm and making recommendations to the board regarding the independent registered public accounting firm; assessing the adequacy of internal controls, accounting methods and procedures; review of public disclosures required for compliance with securities laws; and consideration and review of various other matters relating to the our financial accounting and reporting. No member of the Audit Committee is employed by or has any other material relationship with us other than as a customer or shareholder. The members are "independent" as defined in Rule 5605(a)(2) of the NASDAQ listing standards. The board of directors has adopted a written charter for the Audit Committee which can be found on our website.

In connection with its function to oversee and monitor our financial reporting process, the Audit Committee has done the following:

- reviewed and discussed the audited financial statements for the year ended December 31, 2019 with management;
- discussed with RSM US LLP, our independent registered public accounting firm, those matters which are required to be discussed under the applicable standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”); and
- received the written disclosures and the letter from RSM US LLP required by PCAOB and has discussed with RSM US LLP its independence.

The Audit Committee:  
Michael L. Hansen, Chairman  
Ellen S. Bartel  
Thomas E. Dalum  
Kristine A. Rappé

The information contained in the above report will not be deemed to be “soliciting material” or “filed” with the SEC, nor will this information be incorporated into any future filing under the Securities Act of 1933, as amended (the “Securities Act”), or the Exchange Act except to the extent the Company specifically incorporates such report by reference.

Based on the foregoing, the Audit Committee recommended to the board that those audited financial statements be included in our Annual Report on Form 10-K for the year ended December 31, 2019. In addition, the Audit Committee also considered the fees paid to RSM US LLP for services provided by RSM US LLP during the year ended December 31, 2019.

### **PROPOSAL 3 – RATIFICATION OF THE APPOINTMENT OF OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The firm of RSM US LLP has audited the books and records of Waterstone Financial as of and for the year ended December 31, 2019 and has served as Waterstone Financial’s principal independent accountant since June 3, 2014. Representatives of RSM US LLP are expected to be present at the annual meeting to respond to appropriate questions and to make a statement if they so desire.

The Audit Committee of the Board of Directors has selected RSM US LLP as our independent registered public accountants for the fiscal year ending December 31, 2020. We are submitting the selection of independent registered public accountants for shareholder ratification at the annual meeting. Although not required by the Company’s Articles of Incorporation or Bylaws, the Company has determined to ask shareholders to ratify this selection as a matter of good corporate practice. If the appointment of RSM US LLP is not ratified, the Audit Committee will consider the shareholders’ vote when determining whether to continue the firm’s engagement, but may ultimately determine to continue the engagement of the firm or another audit firm without re-submitting the matter to shareholders. Even if the appointment of RSM US LLP is ratified, the Audit Committee may in its sole discretion terminate the engagement of the firm and direct the appointment of another independent registered public accounting firm at any time during the year if it determines that such an appointment would be in the best interests of our Company and our shareholders.

As reflected in the tables below, Waterstone Financial incurred fees in fiscal years 2019 and 2018 for professional services provided by RSM US LLP related to those periods.

	<b>Year Ended</b>	
	<b>December 31, 2019</b>	<b>December 31, 2018</b>
Audit fees <sup>(1)</sup> .....	\$ 370,000	\$ 295,125
Audit-related fees <sup>(2)</sup> .....	\$ -	\$ 21,000

- (1) Audit fees consist of professional services rendered for the audit of our financial statements and review of our Forms 10-Q.
- (2) Audit-related fees consist of professional services incurred related to a regulatory compliance audit.

**Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services of the Independent Registered Public Accounting Firm**

The Audit Committee’s policy is to pre-approve all audit and non-audit services provided by the independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The Audit Committee has delegated pre-approval authority to its Chairman when expedition of services is necessary. The independent registered public accounting firm and management are required to periodically report to the full Audit Committee regarding the extent of services provided by the independent registered public accounting firm in accordance with this pre-approval, and the fees for the services performed to date. All audit services for the past two fiscal years were pre-approved by the Audit Committee.

**COMPENSATION DISCUSSION AND ANALYSIS**

**Overview of Compensation Program**

**Executive Summary.** The Compensation Committee provides our Named Executive Officers with a total compensation package that is market competitive, promotes the achievement of our strategic objectives and is aligned with operating and other performance metrics to support long-term shareholder value. In addition, we have structured our executive compensation program to include elements that are intended to create appropriate balance between risk and reward.

**Compensation Philosophy.** The primary objectives of our executive compensation programs are to attract and retain highly-qualified executives and to encourage extraordinary management efforts through well-designed incentive opportunities, with the goal of improving the performance of Waterstone Financial, Inc. and its subsidiaries consistent with the interests of our shareholders. We base our compensation decisions on three basic principles:

- Meeting the Demands of the Market – We compensate our employees at competitive levels that position us as the employer of choice among our peers who provide similar financial services in the markets we serve.
- Aligning with Shareholders – We use equity compensation as a key component of our compensation mix to promote a culture of ownership among our key personnel and to align their individual financial interests with the long-term interests of our shareholders.
- Driving Performance – We base compensation in part on the attainment of company-wide, business unit and individual targets that result in the achievement of both short-term and long-term financial objectives, while ensuring sound risk management.

***Elements of our Executive Compensation and Benefits Program.*** To achieve our objectives, we have structured an executive compensation and program that provides our Named Executive Officers with the following:

- Competitive Base Salary;
- Short-Term Cash-Based Incentives;
- Equity Incentive Awards;
- Broad-Based Welfare and Retirement Benefit Plans;
- Perquisites; and
- Executive Agreements.

The programs are intended to reward the accomplishment of strategic plan goals and objectives as evaluated by members of the Compensation Committee. They are further intended to reward enhanced shareholder value as measured by the trading price of our common stock. The elements of a Named Executive Officer's total compensation package will vary depending upon the executive's job position and responsibilities.

### **Compensation Policies and Highlights**

Our compensation programs include, among others, the following best practices:

#### **What We Do**

- ✓ The Compensation Committee has engaged an independent compensation consultant.
- ✓ The Compensation Committee is composed solely of independent directors.
- ✓ We maintain stock ownership guidelines for our executive officers.
- ✓ We maintain stock ownership guidelines for our non-employee directors.
- ✓ We maintain a clawback policy for incentive compensation.
- ✓ We place restrictions on our directors and officers with respect to (i) holding Company securities in a margin account or otherwise pledging Company securities as collateral for a loan or (ii) engaging in hedging transactions in the Company's securities.
- ✓ We provide a say-on-pay advisory vote on an annual basis until the next required vote on the frequency of shareholder votes on executive compensation.

#### **What We Do Not Do**

- × We do not encourage excessive risk-taking behavior through our compensation plans.
- × We do not reprice underwater stock options.
- × We do not grant options with an exercise price less than fair market value on date of grant.
- × We do not provide excessive perquisites to our NEOs.
- × We do not provide excise tax gross ups in our compensation plans or employment agreements.
- × We do not guarantee salary increases.
- × We do not provide for uncapped bonuses.
- × We do not provide for "single-trigger" benefits upon a change in control.

## **Shareholder Say-on-Pay Advisory Votes**

We provide our shareholders with the opportunity to cast an annual advisory vote on executive compensation (a “say-on-pay proposal”). At our 2019 annual meeting of shareholders, over 90% of the votes cast (excluding abstentions and broker non-votes) on the say-on-pay proposal at that meeting were voted in favor of the proposal. The Committee recognized this result as a significant increase from the 49% support received in 2018.

We have held annual say-on-pay votes until the next shareholders vote regarding the frequency of say-on-pay votes, which is occurring at the 2020 annual meeting of shareholders. The Compensation Committee will continue to consider the outcome of our say-on-pay vote, regulatory changes and emerging best practices when making future compensation decisions for the Named Executive Officers.

## **Named Executive Officer Compensation Process, Programs and Policies**

***Role of the Compensation Committee.*** The Compensation Committee is responsible for reviewing all compensation components for the Named Executive Officers annually, including base salary, annual incentive, long-term incentives/equity, benefits and other perquisites. The Compensation Committee examines the total compensation mix, pay-for-performance relationship, and how all these elements in the aggregate comprise each executive’s total compensation package to ensure that our compensation is competitive in the market place and that the mix of benefits accurately reflects our compensation philosophy. The Compensation Committee operates under a written charter that establishes its responsibilities. The Compensation Committee and the Board of Directors review the charter annually to ensure that the scope of the charter is consistent with the role of the Compensation Committee. A copy of the charter can be found on our website on the “Investor Relations” link under the “About” tab, then “Corporate Overview” and “Governance Documents.”

***Role of Management.*** The executive officers who serve as a resource to the Compensation Committee are the President and Chief Executive Officer, with respect to compensation for the other Named Executive Officers, and the Chief Operating Officer and General Counsel and the Assistant Vice President and Director of Human Resources, with respect to compensation of other officers and employees of WaterStone Bank. The executives provide the Compensation Committee with data, analyses, input and recommendation. The Compensation Committee considers our Chief Executive Officer’s evaluation of each Named Executive Officer’s performance and recommendation of appropriate compensation. However, our Chief Executive Officer does not participate in any decisions relating to his own compensation.

***Role of Compensation Consultant.*** The Compensation Committee has the authority to engage compensation consultants from time to time to assist it in the compensation governance process for determining the compensation of our Named Executive Officers. In 2019, the Compensation Committee continued its engagement of Meridian Compensation Partners, LLC, or Meridian, as its independent compensation consultant. Meridian is engaged directly by the Compensation Committee. Pursuant to its engagement, Meridian provides research, data analyses, survey information and design expertise in developing compensation programs for executives and incentive programs for eligible employees. In addition, Meridian keeps the Compensation Committee apprised of regulatory developments and market trends related to executive compensation practices. Meridian does not determine the exact amount or form of executive compensation for and of the Named Executive Officers.

## ***Benchmarking Compensation***

The Committee assesses the components of executive compensation with advice from its independent compensation consultant. During 2018, Meridian provided an analysis of base salary, annual incentive and long-term incentive practices of comparable companies in the financial industry. Meridian considered individual compensation elements as well as the total compensation package. This analysis was considered by the Committee when it established 2019 compensation opportunities for executives. In conducting this analysis, Meridian developed market data using publicly disclosed compensation information from a peer group of comparable financial institutions ranging in asset size from \$1.1 billion to \$3.7 billion. In addition to asset size, peer group selection was also focused on banks with significant mortgage banking operations and/or banks that were recent mutual-to-stock conversions.

For 2019, the Compensation Committee approved the following peer group for purposes of evaluating the appropriateness of the compensation package for the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer and Senior Vice President/Director of Retail Banking:

- Bank Financial Corporation, Burr Ridge, IL
- Blue Hills Bancorp, Inc., Norwood, MA
- BSB Bancorp, Inc., Belmont, MA
- Carolina Financial Corporation, Charleston, SC
- Civista Bancshares, Inc., Sandusky, OH
- ESSA Bancorp, Inc., Stroudsburg, PA
- Farmers & Merchants Bancorp, Inc., Archbold, OH
- First Defiance Financial Corp., Defiance, OH
- FS Bancorp, Inc., Mountlake Terrace, WA
- Green County Bancorp, Inc., Catskill, NY
- HarborOne Bancorp, Inc., Brocton, MA
- Hingham Institutions for Savings, Hingham, MA
- Independent Bank Corporation, Grand Rapids, MI
- Macatawa Bank Corporation, Holland, MI
- MutualFirst Financial, Inc., Muncie, IN
- MVB Financial Corp., Fairmont, WV
- Sterling Bancorp, Inc., Southfield, MI
- United Community Financial Corp., Youngstown, OH

***Stock Ownership Guidelines.*** To align the interests of the Company's Named Executive Officers and non-employee directors with the interests of the Company's shareholders, in March 2019, the Company implemented stock ownership guidelines, where Named Executive Officers of WaterStone Bank are required to own shares of common stock equal to a specified multiple of their annual base salary and non-employee directors are required to own shares of common stock equal to a multiple of such director's annual board cash retainer. The applicable levels are as follows:

- Chief Executive Officer 3x base salary
- Chief Financial Officer 2x base salary
- Other NEO's 1x base salary
- Directors 3x annual board cash retainer

Named Executive Officers and non-employee directors have five years from the date that the individual first become subject to the guidelines to meet these ownership requirements. In calculating equity ownership for purposes of this requirement, we include all shares beneficially owned by an individual in the Company's benefit plans (e.g. 401(k) and Employee Stock Ownership Plan), shares of restricted stock and shares with respect to which an individual has voting or investment power. As of December 31, 2019, all directors would have been in compliance with the Company's stock ownership guidelines. As of December 31, 2019, all Named Executive Officers that have been employed with the Company for at least five years would have been in compliance with the Company's stock ownership guidelines.

***Clawback Policy.*** Our compensation program includes a Clawback Policy, which provides that in the event that the Company is required to prepare an accounting restatement due to its material noncompliance with financial reporting requirements under U.S. securities laws, the Company shall, to the extent permitted by governing law, pursue reimbursement of any performance-based compensation paid to the Named Executive Officer, to the extent such payments and grants were made during the three-year period preceding the date on which the Company is required to prepare an accounting restatement based on the erroneous data, provided that the Compensation Committee or determine that the amount of any such performance-based compensation actually paid or awarded to the Named Executive Officer would have been a lower amount had it been calculated based on such restated financial statements.

## **Components of Executive Compensation and 2019 Decisions**

***Overview.*** Our compensation program consists of five main components: base salary, annual incentives, long-term incentive/equity, board-based welfare and retirement benefit plans and perquisites. The following section



summarizes the role of each component, how decisions are made and the resulting 2019 decision process as it relates to the named executive officers.

**Base Salary.** We provide a base salary for Named Executive Officers commensurate with the services provided to the Company. We believe that a portion of total direct compensation should be provided in a form that is fixed and liquid. In determining the base salary of executive officers for 2019, the Compensation Committee reviewed, among other things, third-party surveys of peer institutions, the historical compensation of those officers under review, any increased level of responsibility and performance measures of Waterstone Financial, Inc. and its subsidiaries. Base salaries for Named Executive Officers other than the Chief Executive Officer are determined based upon recommendations made by the Chief Executive Officer.

<b>Name and Principal Position</b>	<b>2019 (\$)</b>	<b>2018 (\$)</b>	<b>Change (\$)</b>	<b>Change (%)</b>
<b>Douglas S. Gordon</b> Chief Executive Officer of Waterstone Financial and WaterStone Bank	850,000	850,000	—	—
<b>William F. Bruss</b> Chief Operating Officer and General Counsel of Waterstone Financial and WaterStone Bank	318,000	309,000	9,000	2.9%
<b>Mark R. Gerke</b> Chief Financial Officer of Waterstone Financial and WaterStone Bank	206,000	200,000	6,000	3.0%
<b>Julie A. Glynn</b> Senior Vice President and Director of Retail of WaterStone Bank	190,500	185,000	5,500	3.0%
<b>Andy Peach</b> Chief Executive Officer and President of Waterstone Mortgage Corporation (1)	400,000	—	—	—

(1) Mr. Peach was appointed Chief Executive Officer of Waterstone Mortgage Corporation on August 28, 2019.

**Annual Incentive Plan.** In March 2019, we implemented an Annual Incentive Plan which provided Named Executive Officers of WaterStone Bank with annual cash incentive opportunities for annual performance. The ability to earn any award is contingent on the Company achieving consolidated financial-based metrics. These metrics are measured against actual results or actual results compared to our annual budget. The objective of our Annual Incentive Plan is to motivate and reward executives for achieving or exceeding annual financial, strategic and operational goals that we believe will help us maintain long-term profitable growth, maintain asset quality and support value creation for shareholders. The Chief Executive Officer of Waterstone Mortgage Corporation will not participate in the Annual Incentive Plan, but will instead, continue to participate in a cash-based annual incentive plan as set forth in his employment agreement.

Incentive awards are calculated based upon the Company's performance in one of three weighted financial-based measures along with a potential discretionary portion contingent upon achievement of strategic or operational non-financial objectives. With respect to the financial-based measures, performance was measured against the Board-approved 2019 budget or against actual results. To receive any award under the Annual Incentive Plan, the named executive officer must have been actively employed on the day the award is made.

### **Performance Measures**

In designing the Annual Incentive Program, the Compensation Committee emphasized the Company's goals of maintaining profitability, maintaining a strong credit culture and enhancing our franchise value through core deposit growth. The Compensation Committee determined that to encourage these goals, the Annual Incentive Plan would include the following performance measures:

<b>Performance Measure</b>	<b>Weight</b>	<b>Evaluated Against</b>	<b>Rationale</b>
Return on Average Assets	40%	Budget	Focuses management on achieving budgeted net income.
Non-Performing Assets to Total Assets	30%	Actual	Focuses management on adhering to appropriate risk management practices.
Core Deposit Growth	15%	Actual	Focuses management on less costly deposits and growth of business and retail checking and savings accounts, which will help to improve net interest margin.
Individual Performance	15%		Contingent on individual achievement of strategic or operational non-financial objectives.
<b>Total Weighting</b>	<b>100%</b>		

### **Target Annual Incentive Opportunities**

Target incentive awards are defined at the beginning of the year in consideration of market data, each NEO's total compensation package and the Company's budgetary considerations. The following table sets forth information concerning Annual Incentive Plan opportunities for 2019:

<b>Name</b>	<b>Threshold (\$)</b>	<b>Target</b>		
		<b>Amount (\$)</b>	<b>% of Annual Base Salary</b>	<b>Maximum (\$)</b>
<b>Douglas S. Gordon</b>	63,750	127,500	15%	191,250
<b>William F. Bruss</b>	23,850	47,700	15%	71,550
<b>Mark R. Gerke</b>	15,450	30,900	15%	46,350
<b>Julie A. Glynn</b>	38,100	57,150	30%	76,200

### **Performance Measures**

Each NEO had pre-defined performance objectives based upon measurable performance of our Company. In addition, each NEO had the opportunity to earn incentive award based upon individual performance.

The measures and weights of the performance objectives for each NEO for 2019 are summarized in the following table:

<b>Name</b>	<b>Return on Average Assets</b>	<b>Non-Performing Assets to Total Asset</b>	<b>Core Deposit Growth</b>	<b>Individual Performance</b>
<b>Douglas S. Gordon</b>	40%	30%	15%	15%
<b>William F. Bruss</b>	40%	30%	15%	15%
<b>Mark R. Gerke</b>	40%	30%	15%	15%
<b>Julie A. Glynn</b>	40%	30%	15%	15%

### **Performance Results and Payouts**

The Committee, in its sole discretion, determines the final amount of each participant's award based upon the attainment of the applicable performance goals. Each element of the annual cash incentive award is independent

of the other. Accordingly, the Named Executive Officer may achieve certain performance goals, while at the same time fail to achieve others. In that case, the Named Executive Officer would be entitled to receive the award for the performance goal achieved, but not an award for a performance goal for which the threshold performance was not achieved. 2019 performance goals and actual performance were as follows:

2019 Performance Measure	Threshold	Target	Maximum	Actual	Achievement as a % of Target
Return on Average Assets	1.25%	1.40%	1.55%	1.82%	130%
Non-Performing Assets to total Assets	0.70%	0.50%	0.30%	0.40%	79%
Core Deposit Growth	2.50%	5.00%	7.50%	8.23%	165%

Based upon the above financial performance measures and the Committee's discretion with respect to individual performance, the 2019 annual cash incentive payments were awarded as follows relative to the 2019 target value:

Name	2019 Annual Incentive Payment (\$)	% of 2019 Target Annual Incentive
Douglas S. Gordon	181,688	142.5%
William F. Bruss	67,973	142.5%
Mark R. Gerke	44,033	142.5%
Julie A. Glynn	73,343	142.5%

**Equity Incentives.** The Compensation Committee believes that equity-based compensation can provide an important incentive to Named Executive Officers while also aligning their interests with those of shareholders, since the value of the compensation will depend upon stock price performance. The equity incentive elements of total compensation are intended to further the Compensation Committee's objectives of executive retention through longer vesting schedules and enhanced shareholder value due to the value of grants being tied to the trading price of our common stock. All equity awards given to the Named Executive Officers of WaterStone Bank are at the discretion of the Compensation Committee. The Compensation Committee considers the position of the Named Executive Officer, the officer's level of influence and the corresponding ability to contribute toward the success of Waterstone Financial, Inc., and individual and corporate performance as well as the level of equity awards granted to individuals with similar positions at similar companies.

In March 2015, both restricted stock awards and option awards were granted to directors and WaterStone Bank Named Executive Officers, except for the Chief Financial Officer, under our 2015 Equity Incentive Plan. In June 2016, both restricted stock awards and option awards were granted to the Chief Financial Officer. In April 2018, 20,000 incentive stock option awards were granted to the Senior Vice President/Director of Retail Banking. No new awards of restricted stock were granted to any of the named executives during 2019. The Compensation Committee believes that the grants made in 2015 and 2016 still serve the intended purpose of executive and shareholder alignment. See "Executive Compensation-Plan-Based Awards" for additional information about grants made to WaterStone Bank executive officers. The restricted stock awards granted to Named Executive Officers under this plan vest in five installments over four years with the first installment vesting two days after date of grant. The restricted stock awards granted to directors under this plan vest in eight installments over seven years with the first installment vesting two days after date of grant.

In the event of an involuntary termination of employment following a change in control, the unvested equity incentive awards held by each recipient will vest automatically.

**Broad-Based Welfare and Retirement Benefit Plans.** The purpose of welfare and retirement benefit plans are to ensure our compensation packages are competitive and to provide an opportunity for retirement savings. We maintain a number of broad-based welfare benefit plans that are available to our employees, including Named

Executive Officers. We provide group medical, dental and vision insurance coverage plans to employees, with employees being responsible for a portion of the premiums.

We also offer our employees, including Named Executive Officers, participation in tax-qualified defined benefit contribution plans.

***WaterStone Bank Employee Stock Ownership Plan (ESOP).*** The ESOP is a tax-qualified retirement plan that benefits all eligible WaterStone Bank employees proportionately. The ESOP is not separately considered in the review and evaluation of annual executive compensation. ESOP allocations are made annually as of December 31 to all eligible WaterStone Bank employees. An employee must complete a full year of service and be employed by us on December 31 in order to receive an annual allocation each year. A trustee holds the shares purchased by the ESOP in an unallocated suspense account. Shares are released from the suspense account on a pro-rata basis as the ESOP repays the loan. The trustee allocates the shares released among participants on the basis of the participant's proportional share of compensation relative to all participants. In the event of plan termination, all allocated benefits become fully vested immediately, any outstanding loan will be repaid from shares in the unallocated suspense account and the amounts remaining in the suspense account will be allocated to participant accounts proportionally. Dividends paid with respect to shares of Waterstone Financial, Inc. stock in the unallocated suspense account may be used to repay the ESOP loan. To the extent the dividends exceeded the annual loan payment, the remaining dividend amount would cause additional shares to be allocated to participants or may be credited proportionately to participant accounts.

***WaterStone Bank 401(k) Plan.*** WaterStone Bank maintains the WaterStone Bank 401(k) Plan, a tax-qualified defined contribution retirement plan, for all WaterStone Bank, including Named Executive Officers, who have satisfied the 401(k) Plan's eligibility requirements. All eligible employees can begin participation in the 401(k) Plan on the first day of the month that coincides with or follows the date the employee attains age 18. A participant may contribute up to 90% of his or her compensation to the 401(k) Plan on a pre-tax basis, subject to the limitations imposed by the Internal Revenue Code. A participant is 100% vested in his or her salary deferral contributions. In addition to salary deferral contributions, the 401(k) Plan provides that WaterStone Bank will make matching contributions on 20% of the first 5% of the participant's salary that is contributed to the 401(k) Plan.

***Waterstone Mortgage 401(k) Plan.*** Waterstone Mortgage Corporation maintains the Waterstone Mortgage 401(k) Plan, a tax-qualified defined contribution retirement plan, for all Waterstone Mortgage Corporation employees, including Named Executive Officers, who have satisfied the 401(k) Plan's eligibility requirements. All eligible employees can begin participation in the 401(k) Plan on the first day of the month that coincides with or follows the date the employee attains age 21 and completes 60 days of service. A participant may contribute up to 100% of his or her eligible compensation to the 401(k) Plan on a pre-tax basis, subject to the limitations imposed by the Internal Revenue Code. A participant is 100% vested in his or her salary deferral contributions. In addition to salary deferral contributions, the 401(k) Plan provides that Waterstone Mortgage Corporation will make matching contributions on 50% of the first 6% of the participant's salary that is contributed to the 401(k) Plan.

***Perquisites.*** Perquisites comprise a small portion of our total compensation package. The main perquisites we provide are use of a company-owned vehicle or an automobile allowance for selected officers. Although these perquisites may involve personal use, we believe that they are reasonable and consistent with the overall compensation program to assist with attracting and retaining executive officers.

## **Compensation Committee Report**

The Compensation Committee has reviewed and discussed the section of this Proxy Statement entitled "Compensation Discussion and Analysis" with management. Based on this review and discussion, the Compensation Committee recommended to the board of directors that the "Compensation Discussion and Analysis" be included in this Proxy Statement.

Compensation Committee:  
Thomas E. Dalum, Chairman  
Ellen S. Bartel  
Patrick S. Lawton  
Stephen J. Schmidt

#### **PROPOSAL 4– ADVISORY VOTE ON EXECUTIVE COMPENSATION**

The compensation of our principal executive officer, principal financial officer and the three other most highly compensated executive officers of the Company (“Named Executive Officers”) is described above in general and is shown in detail in the Executive Compensation and Compensation Discussion and Analysis sections. Shareholders are urged to read the Executive Compensation and Compensation Discussion and Analysis sections of this Proxy Statement, which discusses our compensation policies and procedures with respect to our Named Executive Officers.

In accordance with Section 14A of the Exchange Act, shareholders will be asked at the Annual Meeting to provide their support with respect to the compensation of our Named Executive Officers by voting on the following advisory, non-binding resolution:

**RESOLVED**, that the compensation paid to the “named executive officers,” as disclosed in the Company’s Proxy Statement for the 2020 Annual Meeting of Shareholders pursuant to Item 402 Securities and Exchange Commission Regulation S-K, including the Compensation Discussion and Analysis, the 2019 compensation tables and narrative discussion is hereby approved.

This advisory vote, commonly referred to as a “say-on-pay” advisory vote, is non-binding on the board of directors. Although non-binding, the board of directors and the Compensation Committee value constructive dialogue on executive compensation and other important governance topics with our shareholders and encourage all shareholders to vote their shares on this matter. The board of directors and the Compensation Committee will review the voting results and take them into consideration when making future decisions regarding our executive compensation.

**Unless otherwise instructed, validly executed proxies will be voted “FOR” this resolution.**

**The board of directors unanimously recommends that you vote “FOR” the resolution set forth in Proposal 4.**

## EXECUTIVE COMPENSATION

**Summary Compensation Table.** The following table shows the compensation of our Named Executive Officers, including Douglas S. Gordon, our principal executive officer, Mark R. Gerke, our principal financial officer, and the three other highest paid executive officers who received total compensation of more than \$100,000 during the year ended December 31, 2019 (collectively, the “Named Executive Officers”). The “Change in Pension Value and Nonqualified Deferred Compensation Earnings” column has been omitted because no listed individual earned any compensation during the listed years of a type required to be disclosed in this column.

SUMMARY COMPENSATION TABLE								
Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)(1)	Option Awards (\$)(1)	Non-Equity Incentive Plan Compensation (\$)	All Other Compensation (\$)(2)	Total (\$)
<b>Douglas S. Gordon</b> Chief Executive Officer of Waterstone Financial and WaterStone Bank	2019	850,000	181,688	—	—	—	187,986	1,219,674
	2018	850,000	—	—	—	—	137,899	987,899
	2017	850,000	—	—	—	—	86,712	936,712
<b>William F. Bruss</b> Chief Operating Officer and General Counsel of Waterstone Financial and WaterStone Bank	2019	318,000	67,973	—	—	—	86,911	472,884
	2018	308,654	—	—	—	—	74,343	382,997
	2017	300,000	—	—	—	—	65,929	365,929
<b>Mark R. Gerke</b> Chief Financial Officer of Waterstone Financial and WaterStone Bank	2019	206,000	44,033	—	—	—	61,353	311,386
	2018	197,308	—	—	—	—	56,949	254,257
	2017	170,000	—	—	—	—	52,410	222,410
<b>Julie A. Glynn</b> Senior Vice President and Director of Retail of WaterStone Bank (3)	2019	190,500	73,343	—	—	—	24,629	288,472
	2018	132,192	40,000	—	72,800	—	4,162	252,154
<b>Andy Peach</b> President of Waterstone Mortgage Corporation (4)	2019	117,239	—	—	—	—	—	117,239

- (1) Reflects the aggregate grant-date fair value of the stock and option awards granted during the years shown as calculated in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718. The assumptions used in the valuation of these awards are included in the “Stock Based Compensation” footnote to Waterstone Financial’s audited financial statements for the years ended December 31, 2019, 2018 and 2017 included in our Annual Report on Form 10-K for such years, as filed with the Securities and Exchange Commission.
- (2) A detailed breakdown of “All Other Compensation” is provided in the table below.
- (3) Ms. Glynn initiated employment with the Company on March 26, 2018.
- (4) Mr. Peach initiated employment with the Company on August 28, 2019. The salary presented in the table reflects the amount paid of the \$400,000 2019 base salary.

### All Other Compensation

Name and Principal Position	401(k) Match (\$)	Employee Stock Ownership Plan (\$)	Automobile Expense Allowance (\$)(2)	Restricted Stock Dividends (\$)	Other (\$)(1)	Total (\$)
<b>Douglas S. Gordon</b>	643	59,795	3,048	124,500	—	187,986
<b>William F. Bruss</b>	1,117	59,795	11,059	14,940	—	86,911
<b>Mark R. Gerke</b>	1,896	43,943	3,992	11,440	—	61,353
<b>Julie A. Glynn</b>	1,463	20,341	2,825	—	—	24,629
<b>Andy Peach (1)</b>	—	—	—	—	—	—

- (1) Mr. Peach initiated employment with the Company on August 28, 2019.

## Employment Agreements

***Employment Agreement with Douglas S. Gordon.*** Effective as of October 21, 2014, WaterStone Bank entered into an employment agreement with Douglas S. Gordon, President and Chief Executive Officer of WaterStone Bank. Commencing on January 1, 2015 (the “Anniversary Date”) and continuing each January 1<sup>st</sup> thereafter, the term shall renew for an additional year such that the remaining term of this Agreement is always three years, unless written notice of non-renewal is provided to Mr. Gordon at least 30 days prior to such Anniversary Date, in which case the term of this Agreement shall become fixed and shall end two years following such Anniversary Date. Under the agreement, Mr. Gordon’s annual base salary for 2020 is \$850,000. In addition, Mr. Gordon is entitled to participate in the employee benefit plans, arrangements and perquisites offered by WaterStone Bank and is entitled to participate in any incentive compensation or bonus plan or arrangement of WaterStone Bank or Waterstone Financial in which he is eligible to participate. The Bank will also pay or reimburse him for business expenses incurred, pay or reimburse him for annual country club dues and furnish him an automobile or reimburse him for the expense of leasing an automobile and for reasonable expenses associated with the use of such automobile.

In the event of Mr. Gordon’s involuntary termination of employment for reasons other than cause, disability, death or retirement, or in the event Mr. Gordon resigns during the term of the agreement for “good reason” (as defined in the agreement), subject to his execution and non-revocation of a mutual release of claims, Mr. Gordon will receive a lump-sum severance payment equal to the sum of (i) his earned but unpaid salary as of the date of his termination of employment, (ii) the benefits he is entitled to as a former employee under the employee benefit plans maintained by WaterStone Bank or Waterstone Financial, (iii) the remaining base salary and bonuses Mr. Gordon would have earned if he had continued his employment for the remaining term of the Agreement and had earned a bonus and/or incentive award in each year in an amount equal to the average bonus and/or incentive award earned by him over the three calendar years preceding the year in which the termination occurs, (iv) the annual contributions or payments that would have been made on Mr. Gordon’s behalf to any employee benefit plans of WaterStone Bank or Waterstone Financial as if Mr. Gordon had continued his employment with WaterStone Bank for the remaining term of the Agreement, and (v) the annual payments that would have been made related to membership in a country club and the use of an automobile for the remaining term of the Agreement. In addition, all awards under the Waterstone Financial, Inc. 2015 Equity Incentive Plan that would have vested had Mr. Gordon continued his employment with WaterStone Bank for the remaining term of the Agreement will vest as of the date of termination, provided that if the terms of the Incentive Plan do not allow for such vesting, WaterStone Bank will make a lump sum payment to Mr. Gordon in an amount equal to the value to Mr. Gordon if such awards had become vested and, with respect to stock options, been exercised. Upon the occurrence of an event of termination described above, Mr. Gordon will be entitled to continued life insurance coverage and non-taxable medical and dental insurance coverage for the remaining term of the agreement.

Upon termination of Mr. Gordon’s employment by Waterstone Financial or WaterStone Bank for reasons other than cause following a change in control of Waterstone Financial or WaterStone Bank, or Mr. Gordon’s resignation due to good reason following a change in control, Mr. Gordon will receive a lump sum payment within 30 days after the date of termination substantially similar to the payment that he would receive on such a termination without regard to a change in control, except that such payments will be for a period of 36 months from date of termination. Mr. Gordon’s payment described in clause (iii) above will be based on the highest annual bonus and/or incentive award earned by him in any of the three calendar years preceding the year in which the termination occurs. Also, the annual contributions or payments that would have been made on Mr. Gordon’s behalf to any employee benefit plans of the Bank or the Company as if Executive had continued his employment with the Bank for a period of 36 months following the Date of Termination, based on contributions or payments made (on an annualized basis) at the Date of Termination and the annual payments that would have been made on Mr. Gordon’s behalf if he had continued his employment with the Bank for a period of 36 months following the Date of Termination. In addition, all awards granted under the Waterstone Financial, Inc. 2015 Equity Incentive Plan will vest as of the date of termination. Upon the occurrence of an event of termination described above, Mr. Gordon will be entitled to continued life insurance coverage and non-taxable medical and dental insurance coverage for a period of 36 months from the date of termination.

In the event of Mr. Gordon’s disability and subsequent termination of employment, Mr. Gordon will receive the benefits provided under any disability program sponsored by Waterstone Financial or WaterStone Bank. To the extent such benefits are less than Mr. Gordon’s base salary at the date of termination, and less than 66 2/3% of Mr.

Gordon's base salary after the first year following termination, Mr. Gordon will be entitled to the difference between the disability benefits provided under any disability program sponsored by Waterstone Financial or WaterStone Bank and his base salary for a period of one year. After the first year following termination, Mr. Gordon will be entitled to the difference between the disability benefits provided under any disability program sponsored by Waterstone Financial or WaterStone Bank and 66 2/3% of Mr. Gordon's base salary, through the earliest to occur of the date of Mr. Gordon's death, recovery from disability or the date Mr. Gordon attains age 65.

In the event of Mr. Gordon's death during the term of the agreement, Mr. Gordon's beneficiary, legal representatives or estate will be paid Mr. Gordon's base salary for one year and WaterStone Bank will continue to provide Mr. Gordon's family the same medical, dental, and other health benefits that were provided by WaterStone Bank to Mr. Gordon's family immediately prior the Mr. Gordon's death, on the same terms, including cost, for one year.

In the event of termination due to Mr. Gordon's retirement, no amount or benefit will be due Mr. Gordon under the Agreement.

The employment agreement restricts Mr. Gordon from revealing confidential information of Waterstone Financial and WaterStone Bank. In addition, for one year following termination of employment (other than upon termination following a change in control), Mr. Gordon may not compete with Waterstone Financial and WaterStone Bank or solicit or hire WaterStone Bank's employees.

***Employment Agreement with Andy Peach.*** Effective as of September 17, 2019, Waterstone Mortgage Corporation entered into an employment agreement with its President, Andy Peach. The agreement has an initial term continuing through August 30, 2022. Thereafter, the agreement shall renew for successive one year terms such that the remaining term of the agreement would always be one year unless written notice of non-renewal was provided by either party at least 90 days prior to such Anniversary Date. Under the agreement, Mr. Peach is entitled to a base salary in 2019 of \$400,000 and participation in company-wide employee benefits, including Waterstone Mortgage Corporation's 401(k) Plan. Beginning in 2020, Mr. Peach is also entitled to annual bonus compensation determined by the Compensation Committee of the Board of Directors of Waterstone Financial, Inc.

Under the agreement, Mr. Peach has the right to terminate his employment for "good reason," which includes any material breach of the agreement by Waterstone Mortgage Corporation, including the failure, without "good cause" (as defined in the agreement), to pay the amounts due under the agreement on a timely basis. In the event the agreement is terminated for good reason or in the event Waterstone Mortgage Corporation terminates Mr. Peach's employment for any reason other than "good cause," subject to his execution and non-revocation of a release of claims, Mr. Peach is entitled to receive his base salary through the remaining term of the agreement. In the event of termination due to disability, Mr. Peach will receive any unpaid base salary earned prior to the effective date of termination and reimbursement of expenses to which Mr. Peach is entitled. In the event of Mr. Peach's death during the term of the agreement, the agreement will terminate with no payment of severance compensation to Mr. Peach's estate. Similarly, in the event of his termination for good cause, Mr. Peach will not be entitled to any severance compensation.

In the event of Mr. Peach's termination of employment, the agreement contains provisions which prevent him from soliciting business from customers of Waterstone Mortgage Corporation, withdrawing any customers' business, hiring any employees, consultants or personnel of Waterstone Mortgage Corporation, disclosing confidential information or competing with Waterstone Mortgage Corporation for two years following termination of employment.

***Change in Control Agreement with Julie Glynn.*** Effective as of April 17, 2018, WaterStone Bank entered into a change in control agreement with Julie Glynn, Senior Vice President and Director of Retail Banking of WaterStone Bank. The agreement has a 36 month term from the effective date and may be extended further in the discretion of WaterStone Bank's Board of Directors. The term of this Agreement shall automatically renew for 90 days in the event of a change in control.

In the event of Ms. Glynn's involuntary termination of employment by WaterStone Bank or her resignation for good reason, as defined in the change in control agreement, occurring within six months prior to a change in control or on or after a change in control during the term of the agreement, Ms. Glynn (or in the event of her subsequent death,



her beneficiary) will be entitled to receive a lump sum severance payment equal to one times her highest rate of base salary and one times the average bonus paid to her during the calendar year in which the change in control occurs and the two immediately preceding years. The payment will be subject to reduction to avoid an excess parachute payment. In the event of an occurrence of a change in control, the agreement will automatically extend for a period of three years following the change in control.

## Plan-Based Awards

**Outstanding Equity Awards at Year End.** The following table sets forth information with respect to outstanding equity awards as of December 31, 2019. Grants were made under our 2006 and 2015 Equity Incentive Plans.

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2019						
Name	Option Awards				Stock Awards	
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)(2)
Douglas S. Gordon	88,627	30,000 (3)	12.75	3/4/2025	—	—
William F. Bruss	24,000	6,000 (3)	12.75	3/4/2025	—	—
Mark R. Gerke	3,292	—	1.73	1/4/2022	—	—
	8,000	2,000 (3)	12.75	3/4/2025	—	—
	6,000	4,000 (3)	14.98	6/21/2026	4,000 (1)	76,120
Julie A. Glynn	4,000	16,000 (3)	17.35	3/20/2028	—	—

(1) Consists of restricted shares awarded on June 21, 2016 under the 2015 Equity Incentive Plan. The restricted shares vest in five increments of 20% each beginning on the June 22, 2016 and subsequently on each anniversary of the initial award.

(2) Based on the \$19.03 per share closing price of our common stock on December 31, 2019.

(3) Options vest in five annual increments of 20% each beginning on the first anniversary of the grant date and subsequently on each anniversary of the date of the initial award.

**Option Exercises and Stock Vested.** The following table sets forth information with respect to option exercises and stock that vested during the year ended December 31, 2019.

OPTION EXERCISES AND STOCK VESTED DURING THE YEAR ENDED DECEMBER 31, 2019				
Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting(#)	Value Realized on Vesting (\$)
Douglas S. Gordon	7,843	32,470	50,000	839,500 (1)
William F. Bruss	—	—	6,000	100,740 (1)
Mark R. Gerke	—	—	4,000	67,640 (2)

(1) Based on the \$16.79 per share closing price of our common stock on March 4, 2019.

(2) Based on the \$16.91 per share closing price of our common stock on June 24, 2019.

## Potential Payments Upon Termination or Change in Control

The following table sets forth estimates of the amounts that would become payable to our Named Executive Officers, under employment agreements and/or equity award agreements in the event of their termination of employment on December 31, 2019, under designated circumstances. The table does not include vested or accrued benefits under any tax-qualified benefit plans that do not discriminate in scope, terms or operation in favor of Executive Officers or equity awards or other benefits in which the executive is vested without regard to the change in control. The estimates shown are highly dependent on a variety of factors, including but not limited to the date of termination, interest rates, federal, state, and local tax rates, and compensation history. Actual payments due could vary substantially from the estimates shown. We consider each termination scenario listed below to be exclusive of all other scenarios and do not expect that any of our Executive Officers would be eligible to collect the benefits shown

under more than one termination scenario. If a Named Executive Officer is terminated for “cause” as defined in the applicable agreement or award, we have no contractual payment or other obligations under the agreement.

<b>POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE IN CONTROL</b>					
	<b><u>Mr. Gordon</u></b>	<b><u>Mr. Bruss</u></b>	<b><u>Mr. Gerke</u></b>	<b><u>Ms. Glynn</u></b>	<b><u>Mr. Peach</u></b>
<b>Discharge Without Cause or Resignation With Good Reason — no Change in Control</b>					
Severance payment	\$ 3,986,497 (1)	\$ —	\$ —	\$ —	\$ 400,000 (1)
Medical, dental and life insurance benefits	35,954 (2)	—	—	—	—
Acceleration of vesting of stock options	188,400 (4)	—	—	—	—
Total	<u>\$ 4,210,851</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 400,000</u>
<b>Discharge Without Cause or Resignation With Good Reason — Change in Control Related</b>					
Severance payment (lump sum)	\$ 6,149,322 (3)	\$ —	\$ —	\$ 230,500 (3)	\$ 400,000 (3)
Medical, dental and life insurance benefits	53,931 (2)	—	—	—	—
Acceleration of vesting of stock options	188,400 (4)	37,680 (4)	19,680 (4)	26,880 (4)	—
Acceleration of vesting of restricted stock	—	—	88,520 (5)	—	—
Total	<u>\$ 6,391,653</u>	<u>\$ 37,680</u>	<u>\$ 108,200</u>	<u>\$ 257,380</u>	<u>\$ 400,000</u>
<b>Disability</b>					
Severance/disability payment	\$ 1,983,333 (6)	\$ —	\$ —	\$ —	\$ —
Acceleration of vesting of stock option	188,400 (4)	37,680 (4)	19,680 (4)	26,880 (4)	—
Acceleration of vesting of restricted stock	—	—	88,520 (5)	—	—
Total	<u>\$ 2,171,733</u>	<u>\$ 37,680</u>	<u>\$ 108,200</u>	<u>\$ 26,880</u>	<u>\$ —</u>
<b>Death</b>					
Salary continuation payment	\$ 850,000 (7)	\$ —	\$ —	\$ 230,500 (7)	\$ —
Medical, dental and life insurance benefits	17,977 (7)	—	—	—	—
Acceleration of vesting of stock options	188,400 (4)	37,680 (4)	19,680 (4)	26,880 (4)	—
Acceleration of vesting of restricted stock	—	—	88,520 (5)	—	—
Total	<u>\$ 1,056,377</u>	<u>\$ 37,680</u>	<u>\$ 108,200</u>	<u>\$ 257,380</u>	<u>\$ —</u>

- (1) The cash severance payment under Mr. Gordon’s employment agreement equals (i) the remaining base salary and employee benefits to which he is entitled under his employment agreement over the remaining term of the agreement, assuming he had earned a bonus equal to the average bonus or incentive award earned over the three calendar years preceding the year of termination, as determined under the agreement; (ii) the annual contributions that would have been made on Mr. Gordon’s behalf under any employee benefit plans in which he participated; and (iii) the annual payments towards automobile lease and expenses that he would be entitled to for the remaining term of the agreement. The severance payment under Mr. Peach’s employment agreement is equal one times his base salary to which he is entitled under his employment agreement payable bi-weekly over a one year period.
- (2) Mr. Gordon will be entitled to non-taxable medical and dental coverage and life insurance coverage for the remaining term of the agreement, in the event of a termination without cause or for good reason not related to a change in control. In the event of an involuntary termination without cause or for good reason following a change in control, Mr. Gordon will be entitled to the continuation of the same benefits for a period of 36 months from the date of termination.
- (3) For Mr. Gordon, the cash severance benefit payable on an involuntary termination of employment or termination for good reason in connection with a change in control is the same as the payment in such a termination that occurs without regard to a change in control, except that such payments would be calculated utilizing the highest bonus or incentive award earned over the three calendar years preceding the year of termination and would be based on a 36-month term. For Mr. Peach, the severance payment under his employment agreement is equal to one year’s base salary to which he is entitled under his employment agreement over the remaining term of the agreement. For Ms. Glynn, the severance payment under her employment agreement is equal to one times the highest rate of base salary paid to Ms. Glynn during the term of the agreement plus one times the average bonus paid in the calendar year in which a change in control occurs plus the two prior years.
- (4) Value is based on the closing price of \$19.03 on December 31, 2019 of Waterstone Financial, Inc. common stock less the exercise price of the stock option.

- (5) Based on the closing price of \$19.03 on December 31, 2019 of Waterstone Financial, Inc. common stock. This includes the value of unvested restricted stock and any accrued dividends on those shares.
- (6) In the event of Mr. Gordon's disability, to the extent that any disability benefits payable under a disability program sponsored by the Bank is less than his base salary during the first year after termination or less than 66-2/3% of his base salary after the first year of his termination, Mr. Gordon will receive a supplement to such disability benefit under the employment agreement to ensure that his aggregate disability benefit is equal to his base salary during the first year and equal to 66-2/3% of his base salary after the first year of his disability. (This benefit can be provided under a supplemental disability policy providing such benefit, in lieu of providing it under the employment agreement.)
- (7) In the event of Mr. Gordon's death, Mr. Gordon's estate, legal representatives or named beneficiary or beneficiaries a base salary for the remaining year along with the same medical, dental, and other health benefits that that would have been made available to Mr. Gordon's family. In the event of Ms. Glynn's death, her beneficiary or estate, will receive a cash lump sum payment equal to one times Officer's highest rate of Base Salary during the term of this Agreement.

### CEO Pay Ratio Disclosure

As required by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and Item 402(u) of Securities and Exchange Commission Regulation S-K, we are providing the following information:

For 2019:

- The median of the annual total compensation of all employees of our company (other than our Chief Executive Officer), was \$66,736; and
- The annual total compensation of Mr. Gordon, our President and Chief Executive Officer was \$1,219,674.

Based on this information, the ratio for 2019 of the annual total compensation of our President and Chief Executive Officer to the median of the annual total compensation of all employees is 18.3 to 1.

We completed the following steps to identify the median employee:

- As of December 31 2019, our employee population consisted of approximately 827 employees, including any full-time, part-time, temporary, or seasonal employees employed on that date.
- To find the median of the annual total compensation of our employees (other than our CEO), we used wages from our payroll records as reported to the Internal Revenue Service on Form W-2 for fiscal 2019. In making this determination, we annualized compensation for full-time and part-time permanent employees who were employed on December 31, 2019, but did not work for us the entire year. No full-time equivalent adjustments were made for part-time employees.
- We identified our median employee using this compensation measure and methodology, which was consistently applied to all our employees included in the calculation.

### Director Compensation

Set forth below is summary compensation for each of our non-employee directors for the year ended December 31, 2019. Compensation includes an annual retainer as well as chairmanship and committee fees.

DIRECTOR COMPENSATION TABLE FOR THE YEAR ENDED DECEMBER 31, 2019		
Name	Fees earned or paid in cash (\$)	Total (\$)
Ellen S. Bartel Nominating Committee Co-chairman	18,000	18,000
Thomas E. Dalum Compensation Committee Chairman	18,000	18,000
Michael L. Hansen Audit Committee Chairman	24,000	24,000
Patrick S. Lawton Chairman of the Board	30,000	30,000
Kristine A. Rappé Executive Committee Chairman	18,000	18,000
Stephen J. Schmidt Nominating Committee Co-chairman	18,000	18,000

In 2019, we paid each non-officer director annual meeting fees of \$18,000. Additional annual fees paid to the Chairman of the Board totaled \$12,000 and additional annual fees paid to the Chairman of the Audit Committee totaled \$6,000.

As of December 31, 2019, Mr. Lawton had 15,000 unvested shares of restricted stock, Mr. Hansen had 12,000 unvested shares of restricted stock, and Bartel, Dalum, Rappe, and Schmidt had 10,500 unvested shares of restricted stock, respectively. Bartel, Dalum, Hansen, Lawton, Rappe, and Schmidt had 50,000 vested but unexercised stock options and 50,000 unvested stock options, respectively.

### **DELINQUENT SECTION 16(a) REPORTS**

Under the federal securities laws, Waterstone Financial directors, its officers and any person holding more than 10% of the common stock are required to report their initial ownership of the common stock and any change in that ownership to the Securities and Exchange Commission. Specific due dates for these reports have been established and we are required to disclose in this Proxy Statement any failure to file such reports by these dates during the last year. Based on our review of such filings, Director Patrick S. Lawton filed a late form 4 to report a transfer of common stock from indirect to direct ownership. We believe that all of our other directors and executive officers complied with these filing requirements on a timely basis for the year ended December 31, 2019.

### **COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

None of the members of the Compensation Committee was an officer or employee of Waterstone Financial, WaterStone Bank or any subsidiary, nor did any of them have any other reportable interlock.

### **TRANSACTIONS WITH CERTAIN RELATED PERSONS**

WaterStone Bank has had, and expects to continue to have, regular business dealings with its officers and directors, as well as their associates and the firms which they serve. Our historical policy has been that transactions with our directors and executive officers be on terms that are no more beneficial to the director or executive officer than we would provide to unaffiliated third parties. Under our policies and procedures, all of our transactions with officers and directors require review, approval or ratification by the board of directors. Directors and executive officers, and their associates, regularly deposit funds with WaterStone Bank. The deposits are made on the same terms and conditions which are offered to other depositors.

In the ordinary course of business, WaterStone Bank makes loans available to its directors, officers and employees. After six months of continuous employment, full-time employees of WaterStone Bank were entitled to receive a mortgage loan at a reduced interest rate, consistent with applicable laws and regulations. In December 2005, the board discontinued the employee loan program for employee loans originated after March 31, 2006. Employee loans at reduced interest rates originated on or before March 31, 2006 continue on their same terms. There were no directors or executive officers who had an employee mortgage loan program loan outstanding at December 31, 2019, 2018 or 2017.

Except for loans to directors made in the ordinary course of business that were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to WaterStone Bank and for which management believes neither involve more than the normal risk of collection nor present other unfavorable features, since January 1, 2019, the beginning of our last fiscal year, we and our subsidiaries have not had any transaction or series of transactions, or business relationships, nor are any such transactions or relationships proposed, in which the amount involved exceeds \$120,000 and in which our directors, executive officers or 5% or more shareholders have a direct or indirect material interest.

### **PROPOSAL 5 – ADVISORY VOTE ON FREQUENCY OF FUTURE VOTES ON “SAY ON PAY” ADVISORY VOTES**

We are providing a stockholder advisory vote to approve the compensation of executives (the “say-on-pay” advisory vote in Proposal 4. above) this year and will do so at least once every three years thereafter. We are also asking stockholders to vote on whether future “say-on-pay” advisory votes on executive compensation should occur every year, every two years or every three years. We will submit to stockholders the question of the frequency of advisory votes on executive compensation at least once every six years.

After careful consideration, the board of directors recommends that future stockholder “say-on-pay” advisory votes on executive compensation be conducted every year. The determination was based upon the premise that Named Executive Officer compensation is evaluated, adjusted and approved on an annual basis by the board of directors upon a recommendation from the compensation committee and the belief that investor sentiment should be a factor taken into consideration by the compensation committee in making its annual recommendation.

Although the board of directors recommends a “say-on-pay” vote every year, stockholders will be able to specify one of four choices for this proposal on the proxy card: one year, two years, three years or abstain. Stockholders are not voting to approve or disapprove of the board of directors’ recommendation.

Although this advisory vote regarding the frequency of “say-on-pay” votes is non-binding on the board of directors, the board of directors and the compensation committee will review the voting results and take them into consideration when deciding how often to conduct future “say-on-pay” stockholder advisory votes.

**Unless otherwise instructed, validly executed proxies will be voted “FOR” the One Year frequency option.**

**The Board of Directors unanimously recommends that you vote “FOR” the One Year option.**

## **SOCIAL AND ENVIRONMENTAL COMMITMENT**

Management and the Board of Directors of Waterstone Financial, Inc. recognize that environmental and social matters impact WaterStone Bank’s business, employees, customers, and stockholders. To that end, management continues to make a commitment to environmental and social initiatives including:

### Social Commitment

- WaterStone Bank employees volunteered over 700 hours for community organizations in 2019.
- Bank employees have leadership roles with over 50 community organizations.
- The WaterStone Bank Foundation awarded more than \$800,000 in grants to more than 240 community organizations during 2019.

### Environmental Awareness

- WaterStone Bank’s low carbon business model seeks to promote responsibility to all stakeholders.
- The Bank installs energy-efficient lighting and appliances in its premises.
- The Bank takes efforts to properly recycle paper, plastic, glass, and metal and produces materials with recycled paper.
- The Bank seeks to reduce consumption, including the utilization of electronic documents to reduce paper usage.
- The Bank adopts technology that can reduce our carbon footprint, such as providing direct and remote deposit capabilities and promoting e-statement enrollment to decrease paper and ink use.

## **SHAREHOLDER PROPOSALS AND NOTICES**

Shareholder proposals must be received by the Secretary of Waterstone Financial, William F. Bruss, no later than December 10, 2020 in order to be considered for inclusion in next year’s annual meeting proxy materials pursuant to Securities and Exchange Commission Rule 14a-8.

Under Securities and Exchange Commission rules relating to the discretionary voting of proxies at shareholder meetings, if a proponent of a matter for shareholder consideration (other than a shareholder proposal) fails to notify Waterstone Financial at least 45 days prior to the month and day of mailing the prior year’s Proxy Statement, then management proxies are allowed to use their discretionary voting authority if a proposal is raised at the annual meeting, without any discussion of the matter in the Proxy Statement. Therefore, any such matters must be received by February 23, 2021 in the case of the 2021 annual meeting of shareholders. Waterstone Financial is not aware of any such proposals for the 2020 annual meeting.

Our Bylaws provide an advance notice procedure for certain business, or nominations to the board of directors, to be brought before an annual meeting of shareholders. In order for a stockholder to properly bring business before an annual meeting, or to propose a nominee to the board of directors, our Secretary must receive written notice not earlier than the 90th day nor later than the 80th day prior to date of the annual meeting; provided, however, that in the event that less than 90 days' notice or prior public disclosure of the date of the annual meeting is provided to shareholders, then, to be timely, notice by the stockholder must be so received not later than the tenth day following the day on which public announcement of the date of such meeting is first made.

The notice with respect to stockholder proposals that are not nominations for director must set forth as to each matter such stockholder proposes to bring before the annual meeting: (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting; (ii) the name and address of such stockholder as they appear on our books and of the beneficial owner, if any, on whose behalf the proposal is made; (iii) the class or series and number of shares of our capital stock which are owned beneficially or of record by such stockholder and such beneficial owner; (iv) a description of all arrangements or understandings between such stockholder and any other person or persons (including their names) in connection with the proposal of such business by such stockholder and any material interest of such stockholder in such business; and (v) a representation that such stockholder intends to appear in person or by proxy at the annual meeting to bring such business before the meeting.

The notice with respect to director nominations must include (i) as to each individual whom the stockholder proposes to nominate for election as a director, (A) all information relating to such person that would indicate such person's qualification under Article 2, Section 12 of our Bylaws, including an affidavit that such person would not be disqualified under the provisions of Article 2, Section 12 of the Bylaws and (B) all other information relating to such individual that is required to be disclosed in connection with solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, or any successor rule or regulation; and (ii) as to the stockholder giving the notice, (A) the name and address of such stockholder as they appear on our books and of the beneficial owner, if any, on whose behalf the nomination is made; (B) the class or series and number of shares of our capital stock which are owned beneficially or of record by such stockholder and such beneficial owner; (C) a description of all arrangements or understandings between such stockholder and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made by such stockholder; (D) a representation that such stockholder intends to appear in person or by proxy at the meeting to nominate the persons named in its notice; and (E) any other information relating to such stockholder that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors pursuant to Regulation 14A under the Securities Exchange Act of 1934 or any successor rule or regulation. Such notice must be accompanied by a written consent of each proposed nominee to be named as a nominee and to serve as a director if elected.

The date on which the next Annual Meeting of Shareholders is expected to be held is May 18, 2021. Assuming the next Annual Meeting of Shareholders is held on May 18, 2021, advance written notice for certain business, or nominations to the Board of Directors, to be brought before the next annual meeting must be given to us no earlier than February 17, 2021 and no later than February 27, 2021. If notice is received before February 17, 2021 or after February 27, 2021, it will be considered untimely, and we will not be required to present the matter at the shareholders meeting.

By Order of the Board of Directors



William F. Bruss  
Executive Vice President and Secretary

Wauwatosa, Wisconsin  
April 9, 2020

**We will provide a copy of the Waterstone Financial Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2019 (without exhibits) without charge to any record or beneficial owner of our common stock on the written request of that person directed to: Mark R. Gerke, Chief Financial Officer, Waterstone Financial, Inc., 11200 W. Plank Ct., Wauwatosa, WI 53226. The 10-K provides a list of exhibits, which will be provided for a reasonable fee to reflect duplication and mailing costs; exhibits are also available through the Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov).**

WATERSTONE FINANCIAL, INC.  
2020 OMNIBUS INCENTIVE PLAN**SECTION 1. Purpose; Definitions**

The purpose of this Plan is to give the Company a competitive advantage in attracting, retaining and motivating officers, employees, directors and/or consultants and to provide the Company and its Subsidiaries and Affiliates with a stock plan providing incentives for future performance of services directly linked to the profitability of the Company's businesses and increases in Company shareholder value.

For purposes of this Plan, the following terms are defined as set forth below:

(a) “*Affiliate*” means a company or other entity controlled by, controlling or under common control with the Company.

(b) “*Applicable Exchange*” means the NASDAQ or such other securities exchange as may at the applicable time be the principal market for the Common Stock.

(c) “*Award*” means a Stock Option, Stock Appreciation Right, Restricted Stock, Restricted Stock Unit, Other Stock-Based Award or Cash Award granted pursuant to the terms of this Plan.

(d) “*Award Agreement*” means a written or electronic document or agreement setting forth the terms and conditions of a specific Award.

(e) “*Board*” means the board of directors of the Company.

(f) “*Business Combination*” has the meaning set forth in Section 9(e)(iii).

(g) “*Cause*” means, unless otherwise provided in an Award Agreement, (i) “Cause” as defined in any Individual Agreement to which the Participant is a party as of the Grant Date, or (ii) if there is no such Individual Agreement or if it does not define Cause: (A) conviction of, or plea of guilty or *nolo contendere* by, the Participant for committing a felony under federal law or the law of the state in which such action occurred, (B) willful and deliberate failure on the part of the Participant in the performance of his or her employment duties in any material respect, (C) dishonesty in the course of fulfilling the Participant's employment duties, (D) a material violation of the Company's ethics and compliance program, code of conduct or other material policy of the Company or (E) prior to a Change in Control, such other events as shall be determined by the Committee. Notwithstanding the general rule of Section 2(c), following a Change in Control, any determination by the Committee as to whether “Cause” exists shall be subject to *de novo* review.



- (h) “*Change in Control*” has the meaning set forth in Section 9(e).
- (i) “*Code*” means the Internal Revenue Code of 1986, as amended from time to time, and any successor thereto, the Treasury Regulations thereunder and other relevant interpretive guidance issued by the Internal Revenue Service or the Treasury Department. Reference to any specific section of the Code shall be deemed to include such regulations and guidance, as well as any successor provision of the Code.
- (j) “*Committee*” means the Committee referred to in Section 2.
- (k) “*Common Stock*” means common stock, \$.01 par value per share, of the Company.
- (l) “*Company*” means Waterstone Financial, Inc., a Maryland corporation, or its successor.
- (m) “*Corporate Transaction*” has the meaning set forth in Section 3(d).
- (n) “*Disability*” means, unless otherwise provided in an Award Agreement, (i) “Disability” as defined in any Individual Agreement to which the Participant is a party, or (ii) if there is no such Individual Agreement or it does not define “Disability,” permanent and total disability as determined under the Company’s Long-Term Disability Plan applicable to the Participant; *provided, however*, to the extent necessary to avoid tax penalties under Section 409A of the Code, “Disability” means “disability” as defined in Section 409(a)(2)(C) of the Code.
- (o) “*Disaffiliation*” means a Subsidiary’s or an Affiliate’s ceasing to be a Subsidiary or Affiliate for any reason (including as a result of a public offering, or a spinoff or sale by the Company, of the stock of the Subsidiary or Affiliate) or a sale of a division of the Company and its Affiliates.
- (p) “*Effective Date*” has the meaning set forth in Section 10(a).
- (q) “*Eligible Individuals*” means directors, officers, employees and consultants of the Company or any of its Subsidiaries or Affiliates, and prospective directors, officers, employees and consultants who have accepted offers of employment or consultancy from the Company or its Subsidiaries or Affiliates.
- (r) “*Exchange Act*” means the Securities Exchange Act of 1934, as amended from time to time, and any successor thereto.
- (s) “*Fair Market Value*” means, except as otherwise determined by the Committee, the closing price of a Share on the Applicable Exchange on the date of measurement or, if Shares were not traded on the Applicable Exchange on such measurement date, then on the next preceding date on which Shares were traded on the Applicable Exchange, as reported by such source as the Committee may select. If there is no regular public trading market for Shares, the Fair Market Value of a Share shall be determined by the Committee in good faith and, to the extent applicable,

such determination shall be made in a manner that satisfies Sections 409A and 422(c)(1) of the Code.

(t) “*Full-Value Award*” means any Award other than a Stock Option or Stock Appreciation Right.

(u) “*Grant Date*” means (i) the date on which the Committee by resolution selects an Eligible Individual to receive a grant of an Award and determines the number of Shares, or the formula for earning a number of Shares, to be subject to such Award or the cash amount subject to such Award, or (ii) such later date as the Committee shall provide in such resolution.

(v) “*Incentive Stock Option*” means any Stock Option designated in the applicable Award Agreement as an “incentive stock option” within the meaning of Section 422 of the Code, and that in fact so qualifies.

(w) “*Incumbent Board*” has the meaning set forth in Section 9(e)(ii).

(x) “*Individual Agreement*” means an employment, consulting or similar agreement between a Participant and the Company or one of its Subsidiaries or Affiliates, and, after a Change in Control, a change in control or salary continuation agreement between a Participant and the Company or one of its Subsidiaries or Affiliates. If a Participant is party to both an employment agreement and a change in control or salary continuation agreement, the employment agreement shall be the relevant “Individual Agreement” prior to a Change in Control, and, the change in control or salary continuation agreement shall be the relevant “Individual Agreement” after a Change in Control.

(y) “*Nonqualified Stock Option*” means any Stock Option that is not an Incentive Stock Option.

(z) “*Other Stock-Based Award*” means an Award granted pursuant to Section 8.

(aa) “*Outstanding Company Common Stock*” has the meaning set forth in Section 9(e)(i).

(bb) “*Outstanding Company Voting Securities*” has the meaning set forth in Section 9(e)(i).

(cc) “*Participant*” means an Eligible Individual to whom an Award is or has been granted.

(dd) “*Performance Goals*” means the performance goals established by the Committee in connection with the grant of an Award. Such goals may be based on the attainment of specified levels of one or more of the following measures, or such other goals as determined by the Committee: stock price, earnings (whether based on earnings before taxes, earnings before interest and taxes or earnings before interest, taxes, depreciation and amortization), earnings per share,

return on equity, return on assets or operating assets, asset quality, net interest margin, loan portfolio growth, efficiency ratio, deposit portfolio growth, liquidity, market share, customer service measures or indices, economic value added, shareholder value added, embedded value added, combined ratio, pre- or after-tax income, net income, cash flow (before or after dividends), cash flow per share (before or after dividends), gross margin, risk-based capital, revenues, revenue growth, return on capital (whether based on return on total capital or return on invested capital), cash flow return on investment, cost control, gross profit, operating profit, cash generation, unit volume, sales, asset quality, cost saving levels, market-spending efficiency, core non-interest income, change in working capital or environmental, social or governance (ESG) factors (including without limitation, goals relating to diversity, inclusion, employee engagement and sustainability), in each case with respect to the Company or any one or more Subsidiaries, divisions, business units or business segments thereof, either in absolute terms or relative to the performance of one or more other companies (including an index covering multiple companies).

(ee) “*Person*” has the meaning set forth in Section 9(e)(i).

(ff) “*Plan*” means the Waterstone Financial, Inc. 2020 Omnibus Incentive Plan, as set forth herein and as hereinafter amended from time to time.

(gg) “*Replaced Award*” has the meaning set forth in Section 9(b).

(hh) “*Replacement Award*” has the meaning set forth in Section 9(b).

(ii) “*Restricted Stock*” means an Award granted under Section 6.

(jj) “*Restricted Stock Unit*” has the meaning set forth in Section 7(a).

(kk) “*Retirement*” means, except as otherwise provided by the Committee, (i) retirement from active employment with the Company or any Affiliate pursuant to the early or normal retirement provisions of the applicable retirement plan of such employer or (ii) pursuant to the retirement scheme applicable under local law or the local policies and procedures of the Company or any Affiliate.

(ll) “*Section 16(b)*” has the meaning set forth in Section 2(g).

(mm) “*Share*” means a share of Common Stock.

(nn) “*Stock Appreciation Right*” means an Award granted under Section 5(b).

(oo) “*Stock Option*” means an Award granted under Section 5(a).

(pp) “*Subsidiary*” means any corporation, partnership, joint venture, limited liability company or other entity during any period in which at least a 50% voting or profits interest is owned, directly or indirectly, by the Company or any successor to the Company.

(qq) “*Term*” means the maximum period during which a Stock Option or Stock Appreciation Right may remain outstanding, subject to earlier termination upon Termination of Service or otherwise, as specified in the applicable Award Agreement.

(rr) “*Termination of Service*” means the termination of the applicable Participant’s employment with, or performance of services for, the Company and any of its Subsidiaries or Affiliates. Unless otherwise determined by the Committee, (i) if a Participant’s employment with the Company and its Affiliates terminates but such Participant continues to provide services to the Company and its Affiliates in a non-employee capacity, such change in status shall not be deemed a Termination of Service and (ii) a Participant employed by, or performing services for, a Subsidiary or an Affiliate or a division of the Company and its Affiliates shall also be deemed to incur a Termination of Service if, as a result of a Disaffiliation, such Subsidiary, Affiliate or division ceases to be a Subsidiary, Affiliate or division, as the case may be, and the Participant does not immediately thereafter become an employee of, or service provider for, the Company or another Subsidiary or Affiliate. Temporary absences from employment because of illness, vacation or leave of absence and transfers among the Company and its Subsidiaries and Affiliates shall not be considered Terminations of Service. Notwithstanding the foregoing provisions of this definition, with respect to any Award that constitutes a “nonqualified deferred compensation plan” subject to Section 409A of the Code, a Participant shall not be considered to have experienced a “Termination of Service” unless the Participant has experienced a “separation from service” within the meaning of Section 409A of the Code (a “*Separation from Service*”).

## **SECTION 2. Administration**

(a) *Committee.* This Plan shall be administered by the Board directly, or if the Board elects, by the Compensation Committee or such other committee of the Board as the Board may from time to time designate, which committee shall be composed of not fewer than two directors, and shall be appointed by and serve at the pleasure of the Board. All references in this Plan to the “Committee” refer to the Board as a whole, unless a separate committee has been designated or authorized consistent with the foregoing.

Subject to the terms and conditions of this Plan, the Committee shall have absolute authority:

- (i) To select the Eligible Individuals to whom Awards may from time to time be granted;
- (ii) To determine whether and to what extent Incentive Stock Options, Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Other Stock-Based Awards, or any combination thereof are to be granted hereunder;
- (iii) To determine the number of Shares to be covered by an Award;

(iv) To approve the form of any Award Agreement and determine the terms and conditions of any Award granted hereunder, including the exercise price and any vesting condition, restriction or limitation;

(v) To modify, amend or adjust the terms and conditions (including any Performance Goals) of any Award;

(vi) To determine to what extent and under what circumstances Shares or cash payable with respect to an Award shall be deferred;

(vii) To determine under what circumstances an Award may be settled in cash, Shares, other property or a combination of the foregoing;

(viii) To adopt, alter and repeal such administrative rules, guidelines and practices governing this Plan as it shall from time to time deem advisable;

(ix) To establish any “blackout” period that the Committee in its sole discretion deems necessary or advisable;

(x) To interpret the terms and provisions of this Plan and any Award issued under this Plan (and any Award Agreement relating thereto);

(xi) To decide all other matters that must be determined in connection with an Award; and

(xii) To otherwise administer this Plan.

(b) *Procedures.*

(i) The Committee may act only by a majority of its members then in office, except that the Committee may, except to the extent prohibited by applicable law or the listing standards of the Applicable Exchange, allocate all or any portion of its responsibilities and powers to any one or more of its members and may delegate all or any part of its responsibilities and powers to any person or persons selected by it. Any such allocation or delegation may be revoked by the Committee at any time.

(ii) Any authority granted to the Committee may be exercised by the full Board. To the extent that any permitted action taken by the Board conflicts with action taken by the Committee, the Board action shall control.

(c) *Discretion of Committee.* Subject to Section 1(h), any determination made by the Committee or pursuant to delegated authority under the provisions of this Plan with respect to any Award shall be made in the sole discretion of the Committee or such delegate at the time of the grant of the Award or, unless in contravention of any express term of this Plan, at any time thereafter. All decisions made by the Committee or any appropriately delegated officer pursuant

to the provisions of this Plan shall be final, binding and conclusive on all persons, including the Company, Participants and Eligible Individuals. Any determination made by the Committee or pursuant to delegated authority under the provisions of this Plan, including conditions for grant or vesting and the adjustment of Awards pursuant to Section 3(d) need not be the same for each Participant.

(d) *Cancellation or Suspension.* Subject to Section 5(c), the Committee shall have full power and authority to determine whether, to what extent and under what circumstances any Award shall be canceled or suspended.

(e) *Award Agreements.* The terms and conditions of each Award, as determined by the Committee, shall be set forth in a written (or electronic) Award Agreement, which shall be delivered to the Participant receiving such Award upon, or as promptly as is reasonably practicable following, the grant of such Award. The effectiveness of an Award shall be subject to the Participant's acceptance of the applicable Award Agreement within the time period specified therein (if any).

(f) *Minimum Vesting Period.* Except for Awards granted with respect to a maximum of five percent (5%) of the Shares authorized in the first sentence of Section 3(a), Award Agreements shall not designate a vesting period of less than one year.

(g) *Section 16(b).* The provisions of this Plan are intended to ensure that no transaction under this Plan is subject to (and all such transactions will be exempt from) the short-swing recovery rules of Section 16(b) of the Exchange Act ("*Section 16(b)*"). Accordingly, the composition of the Committee shall be subject to such limitations as the Board deems appropriate to permit transactions pursuant to this Plan to be exempt (pursuant to Rule 16b-3 promulgated under the Exchange Act) from Section 16(b), and no delegation of authority by the Committee shall be permitted if such delegation would cause any such transaction to be subject to (and not exempt from) Section 16(b).

### **SECTION 3. Common Stock Subject to Plan; Other Limits**

(a) *Plan Maximums.* The maximum number of Shares that may be granted pursuant to Awards under this Plan shall be 1,250,000, of which no more than 500,000 Shares may be issued with respect to Full-Value Awards. The maximum number of Shares that may be granted pursuant to Stock Options intended to be Incentive Stock Options shall be 750,000 Shares. Shares subject to an Award under this Plan may be authorized and unissued Shares. On and after the Effective Date, no new awards may be granted under the Company's prior equity compensation plans, it being understood that awards outstanding under any such plans as of the Effective Date shall remain in full force and effect under such plans according to their respective terms.

(b) *Individual Limits.* The Awards granted under the Plan to a Participant who is not a non-employee director during any calendar year shall not exceed (i) 50,000 Shares covering Stock Options and Stock Appreciation Rights, and (ii) 35,000 Shares covering Full-Value Awards.

(c) *Rules for Calculating Shares Issued.* To the extent that any Award is forfeited, terminates, expires or lapses instead of being exercised, or any Award is settled for cash, the Shares subject to such Awards not delivered as a result thereof shall again be available for Awards under this Plan. If the exercise price of any Stock Option or Stock Appreciation Right and/or the tax withholding obligations relating to any Award are satisfied by delivering Shares (either actually or through a signed document affirming the Participant's ownership and delivery of such Shares) or withholding Shares relating to such Award, the gross number of Shares subject to the Award shall nonetheless be deemed to have been granted for purposes of the first sentence of Section 3(a).

(d) *Adjustment Provisions.*

(i) In the event of a merger, consolidation, acquisition of property or shares, stock rights offering, liquidation, disposition for consideration of the Company's direct or indirect ownership of a Subsidiary or Affiliate (including by reason of a Disaffiliation), or similar event affecting the Company or any of its Subsidiaries (each, a "*Corporate Transaction*"), the Committee or the Board may in its discretion make such substitutions or adjustments as it deems appropriate and equitable to (A) the limits set forth in Sections 3(a) and 3(b); (B) the number and kind of Shares or other securities subject to outstanding Awards; (C) the Performance Goals applicable to outstanding Awards; and (D) the exercise price of outstanding Awards. In the event of a Corporate Transaction, such adjustments may include (I) the cancellation of outstanding Awards in exchange for payments of cash, property or a combination thereof having an aggregate value equal to the value of such Awards, as determined by the Committee in its sole discretion (it being understood that in the event of a Corporate Transaction with respect to which shareholders of Common Stock receive consideration other than publicly traded equity securities of the ultimate surviving entity, any such determination by the Committee that the value of a Stock Option or Stock Appreciation Right shall for this purpose be deemed to equal the excess, if any, of the value of the consideration being paid for each Share pursuant to such Corporate Transaction over the exercise price of such Stock Option or Stock Appreciation Right shall be deemed conclusively valid); (II) the substitution of other property (including cash or other securities of the Company and securities of entities other than the Company) for the Shares subject to outstanding Awards; and (III) in connection with any Disaffiliation, arranging for the assumption of Awards, or replacement of Awards with new awards based on other property or other securities (including other securities of the Company and securities of entities other than the Company), by the affected Subsidiary, Affiliate, or division or by the entity that controls such Subsidiary, Affiliate, or division following such Disaffiliation (as well as any corresponding adjustments to Awards that remain based upon Company securities).

(ii) In the event of a stock dividend, stock split, reverse stock split, reorganization, share combination, or recapitalization or similar event affecting the capital structure of the Company, or a Disaffiliation, separation or spinoff, in each case without consideration, or other extraordinary dividend of cash or other property to the Company's shareholders, the Committee or the Board shall make such substitutions or adjustments as it deems appropriate and equitable to (A) the limits set forth in Sections 3(a) and 3(b); (B) the number and

kind of Shares or other securities subject to outstanding Awards; (C) the Performance Goals applicable to outstanding Awards; and (D) the exercise price of outstanding Awards.

(iii) Any adjustments made pursuant to this Section 3(d) to Awards that are considered “nonqualified deferred compensation” subject to Section 409A of the Code shall be made in compliance with the requirements of Section 409A of the Code. Any adjustments made pursuant to Section 3(d) to Awards that are not considered “nonqualified deferred compensation” subject to Section 409A of the Code shall be made in such a manner as to ensure that after such adjustments, either (A) the Awards continue not to be subject to Section 409A of the Code or (B) there does not result in the imposition of any penalty taxes under Section 409A of the Code in respect of such Awards.

#### **SECTION 4. Eligibility**

Awards may be granted under this Plan to Eligible Individuals; *provided, however*, that Incentive Stock Options may be granted only to employees of the Company and its subsidiaries or parent corporation (within the meaning of Section 424(f) of the Code).

#### **SECTION 5. Stock Options and Stock Appreciation Rights**

(a) *Stock Options.* Stock Options may be granted alone or in addition to other Awards granted under this Plan and may be of two types: Incentive Stock Options and Nonqualified Stock Options. The Award Agreement for a Stock Option shall indicate whether the Stock Option is intended to be an Incentive Stock Option or a Nonqualified Stock Option.

(b) *Stock Appreciation Rights.* Upon the exercise of a Stock Appreciation Right, the Participant shall be entitled to receive an amount in cash or Shares in value equal to the product of (i) the excess of the Fair Market Value of one Share over the exercise price of the applicable Stock Appreciation Right, multiplied by (ii) the number of Shares in respect of which the Stock Appreciation Right has been exercised. The applicable Award Agreement shall specify whether such payment is to be made in cash or Shares, or shall reserve to the Committee or the Participant the right to make that determination prior to or upon the exercise of the Stock Appreciation Right.

(c) *Exercise Price; Prohibition on Repricing.* The exercise price per Share subject to a Stock Option or Stock Appreciation Right shall be determined by the Committee and set forth in the applicable Award Agreement, and shall not be less than the Fair Market Value of a Share on the applicable Grant Date. In no event may any Stock Option or Stock Appreciation Right granted under this Plan be amended, other than pursuant to Section 3(d), to decrease the exercise price thereof, be cancelled in exchange for cash or other Awards or in conjunction with the grant of any new Stock Option or Stock Appreciation Right with a lower exercise price, or otherwise be subject to any action that would be treated, under the Applicable Exchange listing standards or for accounting purposes, as a “repricing” of such Stock Option or Stock Appreciation Right, unless such amendment, cancellation, or action is approved by the Company’s shareholders.



(d) *Term.* The Term of each Stock Option and each Stock Appreciation Right shall be fixed by the Committee, but no Stock Option or Stock Appreciation Right shall be exercisable more than 10 years after its Grant Date.

(e) *Exercisability.* Except as otherwise provided herein, Stock Options and Stock Appreciation Rights shall be exercisable at such time or times and subject to such terms and conditions as shall be determined by the Committee.

(f) *Method of Exercise.* Subject to the provisions of this Section 5, Stock Options and Stock Appreciation Rights may be exercised, in whole or in part, at any time during the Term thereof in accordance with the methods and procedures established by the Committee in the Award Agreement or otherwise.

(g) *Delivery; Rights of Shareholders.* A Participant shall not be entitled to delivery of Shares pursuant to the exercise of a Stock Option or Stock Appreciation Right until the exercise price therefor has been fully paid and applicable taxes have been withheld. Except as otherwise provided in Section 5(k), a Participant shall have all of the rights of a shareholder of the Company holding the number of Shares deliverable pursuant to such Stock Option or Stock Appreciation Right (including, if applicable, the right to vote the applicable Shares), when the Participant (i) has given written notice of exercise, (ii) if requested, has given the representation described in Section 12(a) and (iii) in the case of a Stock Option, has paid in full for such Shares.

(h) *Nontransferability of Stock Options and Stock Appreciation Rights.* No Stock Option or Stock Appreciation Right shall be transferable by a Participant other than, for no value or consideration, by will or by the laws of descent and distribution or as otherwise expressly permitted by the Committee. Any Stock Option or Stock Appreciation Right shall be exercisable, subject to the terms of this Plan, only by the Participant, the guardian or legal representative of the Participant, or any person to whom such stock option is transferred pursuant to this Section 5(h), it being understood that the term “holder” and “Participant” include such guardian, legal representative and other transferee; *provided, however*, that the term “Termination of Service” shall continue to refer to the Termination of Service of the original Participant.

(i) *Termination of Service.* The effect of a Participant’s Termination of Service on any Award of Stock Options or Stock Appreciation Rights then held by such Participant shall be set forth in the applicable Award Agreement or any other document approved by the Committee and applicable to such Award.

(j) *Additional Rules for Incentive Stock Options.* Notwithstanding any other provision of this Plan to the contrary, no Stock Option that is intended to qualify as an Incentive Stock Option may be granted to any Eligible Individual who at the time of such grant owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or of any Subsidiary, unless at the time such Stock Option is granted the exercise price is at least 110% of the Fair Market Value of a Share and such Stock Option by its terms is not exercisable after the expiration of five years from the date such Stock Option is granted. In addition, the aggregate Fair Market Value of the Common Stock (determined at the time a Stock Option for the Common Stock

is granted) for which Incentive Stock Options are exercisable for the first time by a Participant during any calendar year, under all of the incentive stock option plans of the Company and of any Subsidiary, may not exceed \$100,000. To the extent a Stock Option that by its terms was intended to be an Incentive Stock Option exceeds this \$100,000 limit, the portion of the Stock Option in excess of such limit shall be treated as a Nonqualified Stock Option.

(k) *Dividends and Dividend Equivalents.* Dividends (whether paid in cash or Shares) and dividend equivalents may not be paid or accrued on Stock Options or Stock Appreciation Rights; *provided* that Stock Options and Stock Appreciation Rights may be adjusted under certain circumstances in accordance with the terms of Section 3(d).

## **SECTION 6. Restricted Stock**

(a) *Nature of Awards.* Shares of Restricted Stock are actual Shares issued to a Participant that are subject to vesting or forfeiture provisions and may be awarded either alone or in addition to other Awards granted under this Plan.

(b) *Book Entry Registration or Certificated Shares.* Shares of Restricted Stock shall be evidenced in such manner as the Committee may deem appropriate, including book-entry registration. If any certificate is issued in respect of Shares of Restricted Stock, such certificate shall be registered in the name of the Participant and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award, substantially in the following form:

(c) The transferability of this certificate and the shares of stock represented hereby are subject to the terms and conditions (including forfeiture) of the Waterstone Financial, Inc. 2020 Omnibus Incentive Plan and an award agreement. Copies of such plan and award agreement are on file at the offices of Waterstone Financial, Inc., 11200 W. Plank Ct., Wauwatosa, Wisconsin 53226. The Committee may require that the certificates evidencing such Shares be held in custody by the Company until the restrictions thereon shall have lapsed and that, as a condition of any Award of Restricted Stock, the applicable Participant shall have delivered a stock power, endorsed in blank, relating to the Common Stock covered by such Award.

(d) *Terms and Conditions.* Shares of Restricted Stock shall be subject to the following terms and conditions and such other terms and conditions as are set forth in the applicable Award Agreement (including the vesting or forfeiture provisions applicable upon a Termination of Service):

(i) The Committee shall, prior to or at the time of grant, condition (A) the vesting of an Award of Restricted Stock upon the continued service of the applicable Participant, or (B) the grant or vesting of an Award of Restricted Stock upon the attainment of Performance Goals or the attainment of Performance Goals and the continued service of the applicable Participant.

(ii) Subject to the provisions of this Plan and the applicable Award Agreement, a Participant shall not be permitted to sell, assign, transfer, pledge or otherwise encumber an Award of Restricted Stock prior to such time as all applicable vesting conditions are satisfied.

(e) *Rights of a Shareholder.* Except as provided in this Section 6 and the applicable Award Agreement, a Participant shall have the same rights as any other holder of Shares with respect to Shares of Restricted Stock, including, if applicable, the right to vote the Shares and the right to receive any dividends; *provided, however,* that, subject to Section 12(e), (i) cash dividends on Shares shall be payable in cash and shall be held subject to the vesting of the underlying Restricted Stock and (ii) dividends payable in Shares shall be paid in the form of Restricted Stock and shall be held subject to the vesting of the underlying Restricted Stock.

(f) *Termination of Service.* The effect of a Participant's Termination of Service on any Award of Restricted Stock then held by such Participant shall be set forth in the applicable Award Agreement or any other document approved by the Committee and applicable to such Award.

## **SECTION 7. Restricted Stock Units**

(a) *Nature of Awards.* Restricted stock units ("*Restricted Stock Units*") are Awards denominated in Shares that will be settled, subject to the terms and conditions of the applicable Award Agreement, in a specified number of Shares or an amount of cash equal to the Fair Market Value of a specified number of Shares.

(b) *Terms and Conditions.* Restricted Stock Units shall be subject to the following terms and conditions and such other terms and conditions as are set forth in the applicable Award Agreement (including the vesting or forfeiture provisions applicable upon a Termination of Service):

(i) The Committee shall, prior to or at the time of grant, condition (A) the vesting of Restricted Stock Units upon the continued service of the applicable Participant, or (B) the grant or vesting of Restricted Stock Units upon the attainment of Performance Goals or the attainment of Performance Goals and the continued service of the applicable Participant. An Award of Restricted Stock Units shall be settled as and when the Restricted Stock Units vest, at a later time specified by the Committee in the applicable Award Agreement, or, if the Committee so permits, in accordance with an election of the Participant.

(ii) Subject to the provisions of this Plan and the applicable Award Agreement, a Participant shall not be permitted to sell, assign, transfer, pledge or otherwise encumber Restricted Stock Units.

(c) *Rights of a Shareholder.* A Participant to whom Restricted Stock Units are awarded shall have no rights as a shareholder with respect to the Shares represented by the Restricted Stock

Units unless and until Shares are actually delivered to the participant in settlement thereof. Unless otherwise determined by the Committee and subject to Section 12(e), an Award of Restricted Stock Units shall be adjusted to reflect deemed reinvestment in additional Restricted Stock Units of the dividends that would be paid and distributions that would be made with respect to the Award of Restricted Stock Units if it consisted of actual Shares, which additional Restricted Stock Units shall be subject to the same vesting terms as apply to the underlying Restricted Stock Unit.

(d) *Termination of Service.* The effect of a Participant's Termination of Service on any Award of Restricted Stock Units then held by such Participant shall be set forth in the applicable Award Agreement or any other document approved by the Committee and applicable to such Award.

## **SECTION 8. Other Stock-Based Awards**

The Committee may grant Awards of Shares or related to Shares not otherwise described herein in such amounts and subject to such terms and conditions consistent with the terms of this Plan as the Committee shall determine. Without limiting the generality of the preceding sentence, each such Other Stock-Based Award may (a) involve the transfer of actual Shares to Participants, either at the time of grant or thereafter, or payment in cash or otherwise of amounts based on the value of Shares, (b) be subject to performance-based and/or service-based conditions, (c) be in the form of phantom stock, restricted stock, restricted stock units, performance shares, deferred share units or share-denominated performance units, or other Awards denominated in, or with a value determined by reference to, a number of Shares that is specified at the time of the grant of such Award, and (d) be designed to comply with applicable laws of jurisdictions other than the United States.

## **SECTION 9. Change-in-Control Provisions**

(a) *General.* The provisions of this Section 9 shall, subject to Section 3(d), apply notwithstanding any other provision of this Plan to the contrary, except to the extent the Committee specifically provides otherwise in an Award Agreement.

(b) *Impact of Change in Control.* Upon the occurrence of a Change in Control, unless otherwise provided in the applicable Award Agreement: (i) all then-outstanding Stock Options and Stock Appreciation Rights shall become fully vested and exercisable, and all Full-Value Awards (other than performance-based Full-Value Awards) shall vest in full, be free of restrictions, and be deemed to be earned and payable in an amount equal to the full value of such Award, except in each case to the extent that another Award meeting the requirements of Section 9(c) (any award meeting the requirements of Section 9(c), a "*Replacement Award*") is provided to the Participant pursuant to Section 3(d) to replace such Award (any award intended to be replaced by a Replacement Award, a "*Replaced Award*"), and (ii) any performance-based Full-Value Award that is not replaced by a Replacement Award shall be deemed to be earned and payable in an amount equal to the full value of such performance-based Award (with all applicable Performance Goals deemed achieved at the greater of (x) the applicable target level and (y) the level of achievement as determined by the Committee not later than the date of the Change in Control, taking into

account performance through the latest date preceding the Change in Control as to which performance can, as a practical matter, be determined (but not later than the end of the applicable performance period)).

(c) *Replacement Awards.* An Award shall meet the conditions of this Section 9(c) (and hence qualify as a Replacement Award) if: (i) it is of the same type as the Replaced Award; (ii) it has a value equal to the value of the Replaced Award as of the date of the Change in Control, as determined by the Committee in its sole discretion consistent with Section 3(d); (iii) the underlying Replaced Award was an equity-based award, it relates to publicly traded equity securities of the Company or the entity surviving the Company following the Change in Control; (iv) it contains terms relating to vesting (including with respect to a Termination of Service) that are substantially identical to those of the Replaced Award; and (v) its other terms and conditions are not less favorable to the Participant than the terms and conditions of the Replaced Award (including the provisions that would apply in the event of a subsequent Change in Control) as of the date of the Change in Control. Without limiting the generality of the foregoing, a Replacement Award may take the form of a continuation of the applicable Replaced Award if the requirements of the preceding sentence are satisfied. If a Replacement Award is granted, the Replaced Award shall not vest upon the Change in Control. The determination whether the conditions of this Section 9(c) are satisfied shall be made by the Committee, as constituted immediately before the Change in Control, in its sole discretion.

(d) *Termination of Service.* Notwithstanding any other provision of this Plan to the contrary and unless otherwise determined by the Committee and set forth in the applicable Award Agreement, upon a Termination of Service of a Participant by the Company other than for Cause within 24 months following a Change in Control, (i) all Replacement Awards held by such Participant shall vest in full, be free of restrictions, and be deemed to be earned in full (with respect to Performance Goals, unless otherwise agreed in connection with the Change in Control, at the greater of (x) the applicable target level and (y) the level of achievement of the Performance Goals for the Award as determined by the Committee taking into account performance through the latest date preceding the Termination of Service as to which performance can, as a practical matter, be determined (but not later than the end of the applicable performance period)), and (ii) unless otherwise provided in the applicable Award Agreement, notwithstanding any other provision of this Plan to the contrary, any Stock Option or Stock Appreciation Right held by the Participant as of the date of the Change in Control that remains outstanding as of the date of such Termination of Service may thereafter be exercised until the expiration of the stated full Term of such Nonqualified Stock Option or Stock Appreciation Right.

(e) *Definition of Change in Control.* For purposes of this Plan, a “Change in Control” shall mean the occurrence of any of the following events:

(i) An acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act) (a “Person”) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 30% or more of either (1) the then outstanding shares of common stock of the Company (the

“*Outstanding Company Common Stock*”) or (2) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the “*Outstanding Company Voting Securities*”); *provided, however*, that for purposes of this subsection (i), the following acquisitions shall not constitute a Change in Control: (1) any acquisition directly from the Company; (2) any acquisition by the Company; (3) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any entity controlled by the Company; or (4) any acquisition by any entity pursuant to a transaction that complies with clauses (1), (2) and (3) of subsection (iii) of this Section 9(e); or

(ii) A change in the composition of the Board such that the individuals who, as of the Effective Date, constitute the Board (the “*Incumbent Board*”) cease for any reason to constitute at least a majority of the Board; *provided, however*, that any individual who becomes a member of the Board subsequent to the Effective Date whose election, or nomination for election by the Company’s shareholders, was approved by a vote of at least a majority of those individuals who are members of the Board and who were also members of the Incumbent Board (or deemed to be such pursuant to this proviso) shall be considered as though such individual were a member of the Incumbent Board; *provided further*, that any such individual whose initial assumption of office occurs as a result of either an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board shall not be considered as a member of the Incumbent Board; or

(iii) The consummation of a reorganization, merger, statutory share exchange or consolidation or similar transaction involving the Company or any of its Subsidiaries or sale or other disposition of all or substantially all of the assets of the Company, or the acquisition of assets or securities of another entity by the Company or any of its subsidiaries (a “*Business Combination*”), in each case, unless, following such Business Combination: (1) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock (or, for a noncorporate entity, equivalent securities) and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors (or, for a noncorporate entity, equivalent securities), as the case may be, of the entity resulting from such Business Combination (including an entity that, as a result of such transaction, owns the Company or all or substantially all of the Company’s assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be; (2) no Person (excluding any entity resulting from such Business Combination or any employee benefit plan (or related trust) of the Company or such entity resulting from such Business Combination) beneficially owns, directly or indirectly, 30% or more of, respectively, the then outstanding shares of common stock (or, for a

noncorporate entity, equivalent securities) of the entity resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such entity except to the extent that such ownership existed prior to the Business Combination; and (3) at least a majority of the members of the board of directors (or, for a noncorporate entity, equivalent body or committee) of the entity resulting from such Business Combination were members of the Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

(iv) The approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

Notwithstanding any other provision of this Plan, any Award Agreement or any Individual Agreement, with respect to any Award that constitutes “nonqualified deferred compensation” within the meaning of Section 409A of the Code, a Change in Control shall not constitute a settlement or distribution event with respect to such Award, or an event that otherwise changes the timing of settlement or distribution of such Award, unless the Change in Control also constitutes an event described in Section 409A(a)(2)(v) of the Code and the regulations thereto. For the avoidance of doubt, this paragraph shall have no bearing on whether an Award vests pursuant to the terms of this Plan or the applicable Award Agreement or Individual Agreement.

#### **SECTION 10. Term, Termination and Amendment**

(a) *Effectiveness.* This Plan was approved by the Board on March 31, 2020, subject to and contingent upon approval by the Company’s shareholders. This Plan will be effective as of the date of such approval by the Company’s shareholders (the “*Effective Date*”).

(b) *Termination.* This Plan shall terminate on the tenth anniversary of the Effective Date. Awards outstanding as of such date shall not be affected or impaired by the termination of this Plan.

(c) *Amendments.* The Committee may amend, alter, or discontinue this Plan or an Award, *provided* that no amendment, alteration or discontinuation shall be made that would materially impair the rights of the Participant with respect to a previously granted Award without such Participant’s consent, except to the extent necessary to comply with applicable law, including Section 409A of the Code, Applicable Exchange listing standards or accounting rules. In addition, no amendment shall be made without the approval of the Company’s shareholders to the extent such approval is required by applicable law or the listing standards of the Applicable Exchange or as contemplated by Section 5(c).

#### **SECTION 11. Miscellaneous Provisions**

(a) *Conditions for Issuance.* The Committee may require each person purchasing or receiving Shares pursuant to an Award to represent to and agree with the Company in writing that such person is acquiring the Shares without a view to the distribution thereof. The certificates for such Shares may include any legend that the Committee deems appropriate to reflect any

restrictions on transfer. Notwithstanding any other provision of this Plan or agreements made pursuant thereto, the Company shall not be required to issue or deliver any Shares (whether in certificated or book entry form) under this Plan prior to fulfillment of all of the following conditions: (i) listing or approval for listing upon notice of issuance, of such Shares on the Applicable Exchange; (ii) any registration or other qualification of such Shares of the Company under any state or federal law or regulation, or the maintaining in effect of any such registration or other qualification that the Committee shall, in its absolute discretion upon the advice of counsel, deem necessary or advisable; and (iii) obtaining any other consent, approval, or permit from any state or federal governmental agency that the Committee shall, in its absolute discretion, determine to be necessary or advisable.

(b) *Additional Compensation Arrangements.* Nothing contained in this Plan shall prevent the Company or any Subsidiary or Affiliate from adopting other or additional compensation arrangements for its employees.

(c) *No Contract of Employment.* This Plan shall not constitute a contract of employment, and adoption of this Plan shall not confer upon any employee any right to continued employment, nor shall it interfere in any way with the right of the Company or any Subsidiary or Affiliate to terminate the employment of any employee at any time.

(d) *Taxes.*

(i) Withholding. No later than the date as of which an amount first becomes includible in the gross income of a Participant for federal, state, local or foreign income or employment or other tax purposes with respect to any Award under this Plan, such Participant shall pay to the Company, or make arrangements satisfactory to the Company regarding the payment of, any federal, state, local or foreign taxes of any kind required by law to be withheld with respect to such amount. Unless otherwise determined by the Company, withholding obligations may be settled with Common Stock, including Common Stock that is part of the Award that gives rise to the withholding requirement, having a Fair Market Value on the date of withholding equal to the amount to be withheld for tax purposes, all in accordance with such procedures as the Committee establishes. The obligations of the Company under this Plan shall be conditional on such payment or arrangements, and the Company and its Affiliates shall, to the extent permitted by law, have the right to deduct any such taxes from any payment otherwise due to such Participant. The Committee may establish such procedures as it deems appropriate, including making irrevocable elections, for the settlement of withholding obligations with Common Stock; provided, however, unless otherwise subsequently determined by the Committee, with respect to a Participant subject to Section 16 of the Exchange Act, the withholding of Shares by the Company or any of its Affiliates to satisfy tax, exercise price or other withholding obligations in respect of an Award shall be mandatory.

(ii) Section 409A. This Plan and the Awards hereunder are intended to comply with the requirements of Section 409A of the Code or an exemption or exclusion therefrom and, with respect to amounts that are subject to Section 409A of the Code, it is intended that this Plan be administered in all respects in accordance with Section 409A of the Code. Each payment under



any Award shall be treated as a separate payment for purposes of Section 409A of the Code. In no event may a Participant, directly or indirectly, designate the calendar year of any payment to be made under any Award that constitutes nonqualified deferred compensation subject to Section 409A of the Code. Notwithstanding any other provision of this Plan or any Award Agreement to the contrary, if a Participant is a “specified employee” within the meaning of Section 409A of the Code (as determined in accordance with the methodology established by the Company), amounts that constitute “nonqualified deferred compensation” within the meaning of Section 409A of the Code that otherwise would be payable by reason of a Participant’s Separation from Service during the six-month period immediately following such Separation from Service shall instead be paid or provided on the first business day following the date that is six months following the Participant’s Separation from Service or any earlier date permitted by Section 409A of the Code. If the Participant dies following the Separation from Service and prior to the payment of any amounts delayed on account of Section 409A of the Code, such amounts shall be paid to the personal representative of the Participant’s estate within 30 days following the date of the Participant’s death.

(e) *Limitation on Dividend Reinvestment and Dividend Equivalents.* Reinvestment of dividends in additional Restricted Stock at the time of any dividend payment, and the payment of Shares with respect to dividends to Participants holding Awards of Restricted Stock Units, shall only be permissible if sufficient Shares are available under Section 3 for such reinvestment or payment (taking into account then-outstanding Awards). If sufficient Shares are not available for such reinvestment or payment, such reinvestment or payment shall be made in the form of a grant of Restricted Stock Units equal in number to the Shares that would have been obtained by such payment or reinvestment, the terms of which Restricted Stock Units shall provide for settlement in cash and for dividend equivalent reinvestment in further Restricted Stock Units on the terms contemplated by this Section 12(e). Any dividends or dividend equivalents credited with respect to any Award shall be subject to the same time and/or performance-based vesting conditions applicable to such Award and shall, if vested, be delivered or paid at the same time as such Award.

(f) *Designation of Death Beneficiary.* The Committee shall establish such procedures as it deems appropriate for a Participant to designate a beneficiary to whom any amounts payable in the event of such Participant’s death are to be paid or by whom any rights of such eligible Individual, after such Participant’s death, may be exercised.

(g) *Subsidiary Employees.* In the case of a grant of an Award to any employee of a Subsidiary, the Company may, if the Committee so directs, issue or transfer the Shares, if any, covered by the Award to the Subsidiary, for such lawful consideration as the Committee may specify, upon the condition or understanding that the Subsidiary will transfer the Shares to the employee in accordance with the terms of the Award specified by the Committee pursuant to the provisions of this Plan. All Shares underlying Awards that are forfeited or canceled revert to the Company.

(h) *Governing Law and Interpretation.* This Plan and all Awards made and actions taken hereunder shall be governed by and construed in accordance with the laws of the State of

Maryland, without reference to principles of conflict of laws. The captions of this Plan are not part of the provisions hereof and shall have no force or effect. Whenever the words “include,” “includes” or “including” are used in this Plan, they shall be deemed to be followed by the words “but not limited to” and the word “or” shall be understood to mean “and/or.”

(i) *Non-Transferability.* Except as otherwise provided in Sections 5(h) or as determined by the Committee, Awards under this Plan are not transferable except by will or by laws of descent and distribution.

(j) *Unfunded Status of the Plan.* It is intended that this Plan constitute an “unfunded” plan. Neither the Company nor the Committee shall have any obligation to segregate assets or establish a trust or other arrangements to meet the obligations created under this Plan. Any liability of the Company to any Participant with respect to an Award shall be based solely upon contractual obligation created by this Plan and the Award Agreement. No such obligation shall be deemed to be secured by any pledge or encumbrance on the property of the Company.

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2019

Commission file number: 001-36271

**WATERSTONE FINANCIAL, INC.**  
(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation or organization)

90-1026709

(I.R.S. Employer Identification No.)

11200 W Plank Ct, Wauwatosa, Wisconsin

(Address of principal executive offices)

53226

(Zip Code)

(414) 761-1000

Registrant's telephone number, including area code:

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

Title of each class

Trading Symbol

Name of each exchange on which registered

Common Stock, \$0.01 Par Value

WSBF

The NASDAQ Stock Market, LLC

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

NONE

Indicate by check mark whether the registrant is a well-known seasoned issuer (as defined in Rule 405 of the 1933 Act).

Yes  No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the 1934 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 such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files)

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company   
Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 under the Exchange Act).

Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the price at which the common equity was last sold on June 30, 2019 as reported by the NASDAQ Global Select Market®, was approximately \$471.3 million.

As of February 28, 2020, 26,889,750 shares of the Registrant's Common Stock were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Document

Part of Form 10-K Into Which  
Portions of Document are Incorporated

Proxy Statement for Annual Meeting of  
Shareholders on May 19, 2020

Part III

WATERSTONE FINANCIAL, INC.

FORM 10-K ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION  
FOR THE YEAR ENDED DECEMBER 31, 2019

TABLE OF CONTENTS

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<b>ITEM</b>	<b>PAGE</b>
<b>PART I</b>	
1. Business	3 - 28
1A. Risk Factors	29 - 34
1B. Unresolved Staff Comments	35
2. Properties	35
3. Legal Proceedings	35
4. Mine Safety Disclosures	35
<b>PART II</b>	
5. Market for Registrant's Common Equity, Related Stockholders Matters and Issuer Purchases of Equity Securities	36
6. Selected Financial Data	37 - 38
7. Management's Discussion and Analysis of Financial Condition and Results of Operations	39 - 50
7A. Quantitative and Qualitative Disclosures About Market Risk	51
8. Financial Statements and Supplementary Data	52 - 100
9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	100
9A. Controls and Procedures	100 - 101
9B. Other Information	102
<b>PART III</b>	
10. Directors, Executive Officers and Corporate Governance	102
11. Executive Compensation	102
12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	102
13. Certain Relationships and Related Transactions, and Director Independence	103
14. Principal Accountant Fees and Services	103
<b>PART IV</b>	
15. Exhibits and Financial Statement Schedules	103 - 104
16. Form 10-K Summary	103
Signatures	105

**Item 1. Business**

**Forward-Looking Statements**

This Annual Report on Form 10-K may contain or incorporate by reference various forward-looking statements, which can be identified by the use of words such as “estimate,” “project,” “believe,” “intend,” “anticipate,” “plan,” “seek,” “expect” and similar expressions and verbs in the future tense. These forward-looking statements include, but are not limited to:

- Statements of our goals, intentions and expectations;
- Statements regarding our business plans, prospects, growth and operating strategies;
- Statements regarding the quality of our loan and investment portfolio;
- Estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management 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.

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.

- general economic conditions, either nationally or in our market area, including employment prospects, that are different than expected;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins and yields, our mortgage banking revenues or reduce the fair value of financial instruments or reduce the origination levels in our lending business, or increase the level of defaults, losses or prepayments on loans we have made and make whether held in portfolio or sold in the secondary markets;
- adverse changes in the securities or secondary mortgage markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- changes in monetary or fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board;
- our ability to manage market risk, credit risk and operational risk in the current economic conditions;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities;
- decreased demand for our products and services;
- changes in tax policies or assessment policies;
- the inability of third-party provider to perform their obligations to us;
- changes in consumer demand, 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 or the Public Company Accounting Oversight Board;
- our ability to retain key employees;
- cyber attacks, computer viruses and other technological risks that may breach the security of our websites or other systems to obtain unauthorized access to confidential information and destroy data or disable our systems;
- technological changes that may be more difficult or expensive than expected;
- the ability of third-party providers to perform their obligations to us;
- the effects of federal government shutdown;
- the ability of the U.S. Government to manage federal debt limits;
- significant increases in our loan losses; and
- changes in the financial condition, results of operations or future prospects of issuers of securities that we own.

See also the factors regarding future operations discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" below.

**Waterstone Financial, Inc.**

Waterstone Financial, Inc., a Maryland corporation (“New Waterstone”), was organized in 2013. Upon completion of the mutual-to-stock conversion of Lamplighter Financial, MHC in 2014, New Waterstone became the holding company of WaterStone Bank SSB and succeeded to all of the business and operations of Waterstone Financial, Inc., a Federal corporation (“Waterstone-Federal”) and each of Waterstone-Federal and Lamplighter Financial, MHC ceased to exist. In this report, we refer to WaterStone Bank SSB, our wholly owned subsidiary, both before and after the reorganization, as “WaterStone Bank” or the “Bank.”

Waterstone Financial, Inc. and its subsidiaries, including WaterStone Bank, are referred to herein as the “Company,” “Waterstone Financial,” or “we.”

The Company maintains a website at [www.wsbonline.com](http://www.wsbonline.com). We make available through that website, free of charge, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports and proxy materials as soon as is reasonably practical after the Company electronically files those materials with, or furnishes them to, the Securities and Exchange Commission. You may access those reports by following the links under “Investor Relations” at the Company’s website. Information on this website is not and should not be considered a part of this document.

Waterstone Financial’s executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226, and its telephone number at this address is (414) 761-1000.

## BUSINESS OF WATERSTONE BANK

### General

WaterStone Bank is a community bank that has served the banking needs of its customers since 1921. WaterStone Bank also has an active mortgage banking subsidiary, Waterstone Mortgage Corporation, which had 67 offices in 24 states as of December 31, 2019.

WaterStone Bank conducts its community banking business from 13 banking offices located in Milwaukee, Washington and Waukesha counties, Wisconsin, as well as a loan production office in Minneapolis, Minnesota. WaterStone Bank's principal lending activity is originating one- to four-family, multi-family residential, and commercial real estate loans for retention in its portfolio. At December 31, 2019, such loans comprised 34.6%, 42.1%, and 17.1%, respectively, of WaterStone Bank's loan portfolio. WaterStone Bank also offers home equity loans and lines of credit, construction and land loans, commercial business loans, and consumer loans. WaterStone Bank funds its loan production primarily with retail deposits and Federal Home Loan Bank advances. Our deposit offerings include certificates of deposit, money market savings accounts, transaction deposit accounts, noninterest bearing demand accounts and individual retirement accounts. Our investment securities portfolio is comprised principally of mortgage-backed securities, government-sponsored enterprise bonds, municipal obligations, and other debt securities.

WaterStone Bank is subject to comprehensive regulation and examination by the Wisconsin Department of Financial Institutions (the "WDFI") and the Federal Deposit Insurance Corporation (the "FDIC").

WaterStone Bank's executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226, and its telephone number is (414) 761-1000. Its website address is [www.wsbonline.com](http://www.wsbonline.com). Information on this website is not and should not be considered a part of this document.

WaterStone Bank's mortgage banking operations are conducted through its wholly-owned subsidiary, Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originates single-family residential real estate loans for sale into the secondary market. Waterstone Mortgage Corporation utilizes lines of credit provided by WaterStone Bank as a primary source of funds, and also utilizes a line of credit with another financial institution as needed. On a consolidated basis, Waterstone Mortgage Corporation originated approximately \$2.85 billion in mortgage loans held for sale during the year ended December 31, 2019, which excludes the loans originated from Waterstone Mortgage Corporation and purchased by WaterStone Bank.

### Subsidiary Activities

Waterstone Financial currently has one wholly-owned subsidiary, WaterStone Bank, which in turn has three wholly-owned subsidiaries. Wauwatosa Investments, Inc., which holds and manages our investment portfolio, is located and incorporated in Nevada. Waterstone Mortgage Corporation is a mortgage banking business incorporated in Wisconsin. Main Street Real Estate Holdings, LLC is a Wisconsin limited liability corporation and previously owned WaterStone Bank office facilities and held WaterStone Bank office facility leases.

**Wauwatosa Investments, Inc.** Established in 1998, Wauwatosa Investments, Inc. operates in Nevada as WaterStone Bank's investment subsidiary. This wholly-owned subsidiary owns and manages the majority of the consolidated investment portfolio. It has its own board of directors currently comprised of its President, the WaterStone Bank Chief Financial Officer, Treasury Officer and the Chairman of Waterstone Financial's board of directors.

**Waterstone Mortgage Corporation.** Acquired in February 2006, Waterstone Mortgage Corporation is a mortgage banking business with offices in 24 states. It has its own board of directors currently comprised of its President, its Chief Financial Officer, the WaterStone Bank Chief Executive Officer, Chief Financial Officer and Executive Vice President and General Counsel.

**Main Street Real Estate Holdings, LLC.** Established in 2002, Main Street Real Estate Holdings, LLC was established to acquire and hold WaterStone Bank office and retail facilities, both owned and leased. Main Street Real Estate Holdings, LLC currently conducts real estate broker activities limited to real estate owned.

### Market Area

**WaterStone Bank.** WaterStone Bank's market area is broadly defined as the Milwaukee, Wisconsin metropolitan market, which is geographically located in the southeast corner of the state. WaterStone Bank's primary market area is Milwaukee and Waukesha counties and the five surrounding counties of Ozaukee, Washington, Jefferson, Walworth and Racine. We have eight branch offices in Milwaukee County, four branch offices in Waukesha County and one branch office in Washington County. At June 30, 2019 (the latest date for which information was publicly available), 47.0% of deposits in the State of Wisconsin were located in the seven-county Milwaukee metropolitan market and 39.9% of deposits in the State of Wisconsin were located in the three counties in which the Bank has a branch office.

WaterStone Bank's primary market area for deposits includes the communities in which we maintain our banking office locations. Our primary lending market area is broader than our primary deposit market area and includes all of the primary market area noted above but extends further west to the Madison, Wisconsin market and further north to the Appleton and Green Bay, Wisconsin markets. Additionally, in 2013 we opened a loan production office in Minneapolis, Minnesota, which has a primary lending market area of the Minneapolis-St. Paul, Minnesota metropolitan market.

**Waterstone Mortgage Corporation.** As of December 31, 2019, Waterstone Mortgage Corporation had 10 offices in each of Wisconsin and Florida, eight offices in New Mexico, three offices in each of Delaware, Illinois, Minnesota, and Virginia, two offices in each of Arizona, Colorado, Maryland, Missouri, Ohio, Oklahoma, Oregon, and Virginia, and one office in each of Arkansas, California, Georgia, Idaho, Iowa, Michigan, New Hampshire, North Carolina and Pennsylvania.

## Competition

**WaterStone Bank.** WaterStone Bank faces competition within our market area both in making real estate loans and attracting deposits. The Milwaukee-Waukesha-West Allis metropolitan statistical area has a high concentration of financial institutions, including large commercial banks, community banks and credit unions. As of June 30, 2019, based on the FDIC annual Summary of Deposits Report, we had the eighth largest market share in our metropolitan statistical area out of 43 financial institutions, representing 1.88% of all deposits.

Our competition for loans and deposits comes principally from commercial banks, savings institutions, mortgage banking firms and credit unions. We face additional competition for deposits from money market funds, brokerage firms, and mutual funds. Some of our competitors offer products and services that we do not offer, such as trust services and private banking.

Our primary focus is to build and develop profitable consumer and commercial customer relationships while maintaining our role as a community bank.

**Waterstone Mortgage Corporation.** Waterstone Mortgage Corporation faces competition for originating loans both directly within the markets in which it operates and from entities that provide services throughout the United States through internet services. Waterstone Mortgage Corporation's competition comes principally from other mortgage banking firms, as well as from commercial banks, savings institutions and credit unions.

## Lending Activities

The scope of the discussion included under "Lending Activities" is limited to lending operations related to loans originated for investment. A discussion of the lending activities related to loans originated for sale is included under "Mortgage Banking Activities."

Historically, our principal lending activity has been originating mortgage loans for the purchase or refinancing of residential and commercial real estate. Generally, we retain the loans that we originate, which we refer to as loans originated for investment. One- to four-family residential mortgage loans represented \$480.3 million, or 34.6%, of our total loan portfolio at December 31, 2019. Multi-family residential mortgage loans represented \$584.9 million, or 42.1%, of our total loan portfolio at December 31, 2019. Commercial real estate loans represented \$236.7 million, or 17.1%, of our total loan portfolio at December 31, 2019. We also offer construction and land loans, home equity lines of credit and commercial loans. At December 31, 2019, commercial business loans, home equity loans, and land and construction loans totaled \$30.3 million, \$18.1 million and \$37.0 million, respectively.

The largest exposure to one borrower or group of related borrowers was \$39.1 million in the multi-family category. The borrower represented a total of 2.8% of the total loan portfolio as of December 31, 2019.

**Loan Portfolio Composition.** The following table sets forth the composition of our loan portfolio in dollar amounts and as a percentage of the total portfolio at the dates indicated.

	At December 31,									
	2019		2018		2017		2016		2015	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Mortgage loans:										
Residential real estate:										
One- to four-family	\$ 480,280	34.60%	\$ 489,979	35.53%	\$ 439,597	34.03%	\$ 392,817	33.35%	\$ 381,992	34.26%
Multi-family	584,859	42.14%	597,087	43.29%	578,440	44.77%	558,592	47.42%	547,250	49.08%
Home equity	18,071	1.30%	19,956	1.45%	21,124	1.64%	21,778	1.85%	24,326	2.18%
Construction and land	37,033	2.67%	13,361	0.97%	19,859	1.54%	18,179	1.54%	19,148	1.72%
Commercial real estate	236,703	17.05%	225,522	16.35%	195,842	15.16%	159,401	13.53%	118,820	10.66%
Commercial loans	30,253	2.18%	32,810	2.38%	36,697	2.84%	26,798	2.28%	23,037	2.07%
Consumer	832	0.06%	433	0.03%	255	0.02%	319	0.03%	361	0.03%
Total loans	<u>1,388,031</u>	<u>100.00%</u>	<u>1,379,148</u>	<u>100.00%</u>	<u>1,291,814</u>	<u>100.00%</u>	<u>1,177,884</u>	<u>100.00%</u>	<u>1,114,934</u>	<u>100.00%</u>
Allowance for loan losses	(12,387)		(13,249)		(14,077)		(16,029)		(16,185)	
Loans, net	<u>\$ 1,375,644</u>		<u>\$ 1,365,899</u>		<u>\$ 1,277,737</u>		<u>\$ 1,161,855</u>		<u>\$ 1,098,749</u>	

**Loan Portfolio Maturities and Yields.** The following table summarizes the final maturities of our loan portfolio at December 31, 2019. Maturities are based upon the final contractual payment dates and do not reflect the impact of prepayments and scheduled monthly payments that will occur.

Due during the year ended December 31,	One- to four-family		Multi-family		Home Equity		Construction and Land	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in Thousands)							
2020	\$ 7,496	5.15%	\$ 40,731	4.06%	\$ 2,270	5.34%	\$ 1,840	4.92%
2021	10,084	5.19%	35,374	4.39%	2,063	5.34%	10,194	4.54%
2022	23,730	5.25%	89,802	4.44%	2,579	5.25%	4,887	4.23%
2023	16,549	5.40%	93,123	4.65%	2,320	5.13%	2,130	4.76%
2024	14,729	5.45%	49,482	4.72%	2,603	4.93%	2,848	4.55%
2025 and thereafter	407,692	4.60%	276,347	4.12%	6,236	4.75%	15,134	4.82%
Total	<u>\$ 480,280</u>	4.71%	<u>\$ 584,859</u>	4.32%	<u>\$ 18,071</u>	5.04%	<u>\$ 37,033</u>	4.64%

Due during the year ended December 31,	Commercial Real Estate		Commercial		Consumer		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
	(Dollars in Thousands)							
2020	\$ 13,738	4.37%	\$ 13,304	5.04%	\$ 717	2.00%	\$ 80,096	4.42%
2021	17,740	4.12%	1,178	4.46%	52	5.13%	76,685	4.48%
2022	34,199	4.41%	4,338	4.33%	63	5.38%	159,598	4.50%
2023	37,355	4.43%	2,437	5.12%	-	0.00%	153,914	4.69%
2024	45,620	4.60%	2,493	4.61%	-	0.00%	117,775	4.76%
2025 and thereafter	88,051	4.44%	6,503	6.69%	-	0.00%	799,963	4.44%
Total	<u>\$ 236,703</u>	4.44%	<u>\$ 30,253</u>	5.24%	<u>\$ 832</u>	2.45%	<u>\$ 1,388,031</u>	4.50%

The following table sets forth the scheduled repayments of fixed and adjustable rate loans at December 31, 2019 that are contractually due after December 31, 2020.

	Due After December 31, 2020		
	Fixed	Adjustable	Total
	(In Thousands)		
Mortgage loans			
Real estate loans:			
One- to four-family	\$ 24,939	\$ 447,845	\$ 472,784
Multi-family	207,845	336,283	544,128
Home equity	3,600	12,201	15,801
Construction and land	19,817	15,376	35,193
Commercial	138,569	84,396	222,965
Commercial	16,098	851	16,949
Consumer	115	-	115
Total loans	<u>\$ 410,983</u>	<u>\$ 896,952</u>	<u>\$ 1,307,935</u>

**One- to Four-Family Residential Mortgage Loans.** One- to four-family residential mortgage loans totaled \$480.3 million, or 34.6% of total loans at December 31, 2019. One- to four-family residential mortgage loans originated for investment during the year ended December 31, 2019 totaled \$95.5 million, or 29.1% of all loans originated for investment. Our one- to four-family residential mortgage loans have fixed or adjustable rates. Our single family adjustable-rate mortgage loans generally provide for maximum annual rate adjustments of 200 basis points, with a lifetime maximum adjustment of 600 basis points. Our adjustable-rate mortgage loans typically amortize over terms of up to 30 years, and are indexed to the 12-month LIBOR rate. Single family adjustable rate mortgage loans are originated at both our community banking segment and our mortgage banking segment. We do not offer and have never offered residential mortgage loans specifically designed for borrowers with sub-prime credit scores, including Alt-A and negative amortization loans. Further, prior to 2007, we did not offer indexed, adjustable-rate loans other than home equity lines of credit, and we have never offered “teaser rate” first mortgage products.



Adjustable rate mortgage loans can decrease the interest rate risk associated with changes in market interest rates by periodically repricing, but involve other risks because, as interest rates increase, the loan payments by the borrower increase, thus 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 adjustment of the contractual interest rate is also limited by the maximum periodic and lifetime interest rate adjustments permitted by our loan documents and, therefore, the effectiveness of adjustable rate mortgage loans in decreasing the risk associated with changes in interest rates may be limited during periods of rapidly rising interest rates. Moreover, during periods of rapidly declining interest rates the interest income received from the adjustable rate loans can be significantly reduced, thereby adversely affecting interest income.

All residential mortgage loans that we originate include “due-on-sale” clauses, which give us the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise transfers the real property subject to the mortgage and the loan is not repaid. We also require homeowner’s insurance and where circumstances warrant, flood insurance, on properties securing real estate loans. The average one- to four-family first mortgage loan balance was approximately \$225,000 on December 31, 2019, and the largest outstanding balance on that date was \$6.3 million, which is a consolidation loan that is collateralized by 85 single family properties. A total of 58.8% of our one- to four-family loans are collateralized by properties in the state of Wisconsin.

**Multi-family Real Estate Loans.** Multi-family loans totaled \$584.9 million, or 42.1% of total loans at December 31, 2019. Multi-family loans originated for investment during the year ended December 31, 2019 totaled \$110.1 million, or 33.5% of all loans originated for investment. These loans are generally secured by properties located in our primary market area. Our multi-family real estate underwriting policies generally provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property provided the loan complies with our current loans-to-one borrower limit. Multi-family real estate loans are offered with interest rates that are fixed for periods of up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 30-year amortization period. In reaching a decision whether to make a multi-family real estate loan, we consider gross revenues and the net operating income of the property, the borrower’s expertise and credit history, global cash flows, and the appraised value of the underlying property. We will also consider the terms and conditions of the leases and the credit quality of the tenants. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, income taxes, depreciation and amortization divided by interest expense and current maturities of long term debt) of at least 1.15 times. Generally, multi-family loans made to corporations, partnerships and other business entities require personal guarantees from the principals and by the owners of 20% or more of the borrower.

A multi-family borrower’s financial information is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We generally require borrowers with aggregate outstanding balances exceeding \$1.0 million to provide updated financial statements and federal tax returns annually. These requirements also apply to all guarantors on these loans. We also require borrowers with rental investment property to provide an annual report of income and expenses for the property, including a tenant list and copies of leases, as applicable. The average outstanding multi-family mortgage loan balance was approximately \$985,000 on December 31, 2019, with the largest outstanding balance at \$11.9 million.

Loans secured by multi-family real estate generally involve larger principal amounts than owner-occupied, one- to four-family residential mortgage loans. Because payments on loans secured by multi-family properties often depend on the successful operation or management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy.

**Home Equity Loans and Lines of Credit.** We also offer home equity loans and home equity lines of credit, both of which are secured by owner-occupied and non-owner occupied one- to four-family residences. At December 31, 2019, outstanding home equity loans and equity lines of credit totaled \$18.1 million, or 1.3% of total loans outstanding. At December 31, 2019, the unadvanced portion of home equity lines of credit totaled \$13.4 million. Home equity loans and lines originated for investment during the year ended December 31, 2019 totaled \$5.8 million, or 1.8% of all loans originated for investment. The underwriting standards utilized for home equity loans and home equity lines of credit include a determination of the applicant’s credit history, an assessment of the applicant’s ability to meet existing obligations and payments on the proposed loan, and the value of the collateral securing the loan. Home equity loans are offered with adjustable rates of interest and with terms up to 10 years. The loan-to-value ratio for our home equity loans and our lines of credit is generally limited to 90% when combined with the first security lien, if applicable. Our home equity lines of credit have ten-year terms and adjustable rates of interest, subject to a contractual floor, which are indexed to the prime rate, as reported in *The Wall Street Journal*. Interest rates on home equity lines of credit are generally limited to a maximum rate of 18%. The average outstanding home equity loan balance was approximately \$45,000 at December 31, 2019, with the largest outstanding balance at that date of \$515,000.

**Construction and Land Loans.** We originate construction loans for the acquisition of land and the construction of single-family residences, multi-family residences, and commercial real estate buildings. At December 31, 2019, construction and land loans totaled \$37.0 million, or 2.7% of total loans. Construction and land loans originated for investment during the year ended December 31, 2019 totaled \$59.8 million, or 18.2% of all loans originated for investment. Of the \$59.8 million originated in 2019, a total of \$47.4 million had yet to be advanced as of December 31, 2019. At December 31, 2019, the unadvanced portion of the construction loan portfolio totaled \$91.4 million.

Our construction mortgage loans generally provide for the payment of interest only during the construction phase, which is typically up to nine months for single-family residences although our policy is to consider construction periods as long as 12 months or more for multi-family residences and commercial buildings. At the end of the construction phase, the construction loan converts to a longer-term mortgage loan. Construction loans can be made with a maximum loan-to-value ratio of 90%, provided that the borrower obtains private mortgage insurance if the owner-occupied residential loan balance exceeds 80% of the lesser of the appraised value or acquisition cost of the secured property. The average outstanding construction loan balance totaled approximately \$1.7 million on December 31, 2019, with the largest outstanding balance at \$11.6 million. The average outstanding land loan balance was approximately \$194,000 on December 31, 2019, and the largest outstanding balance on that date was \$1.0 million.

Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We also review and inspect each property before disbursement of funds during the term of the construction loan. Loan proceeds are disbursed after inspection based on either the percentage of completion method or the actual cost of the completed work.

Construction financing is generally considered to involve a higher degree of credit risk than longer-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost is inaccurate, we may be required to advance funds beyond the amount originally committed in order to protect the value of the property. Additionally, if the estimate of value is inaccurate, we may be confronted with a project, when completed, with a value that is insufficient to ensure full repayment of the loan.

**Commercial Real Estate Loans.** Commercial real estate loans totaled \$236.7 million at December 31, 2019, or 17.1% of total loans, and are made up of loans secured by office and retail buildings, industrial buildings, churches, restaurants, other retail properties and mixed use properties. Commercial real estate loans originated for investment during the year ended December 31, 2019 totaled \$49.7 million, or 15.1% of all loans originated for investment. These loans are generally secured by property located in our primary market area. Our commercial real estate underwriting policies provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property. Commercial real estate loans are offered with interest rates that are fixed up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 25 to 30-year amortization period. In reaching a decision whether to make a commercial real estate loan, we consider gross revenues and the net operating income of the property, the borrower's expertise and credit history, business and global cash flow, and the appraised value of the underlying property. In addition, we will also consider the terms and conditions of the leases and the credit quality of the tenants, if applicable. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, income taxes, depreciation and amortization divided by interest expense and current maturities of long term debt) of at least 1.15 times. Environmental surveys are required for commercial real estate loans when environmental risks are identified. Generally, commercial real estate loans made to corporations, partnerships and other business entities require personal guarantees by the principals and by the owners of 20% or more of the borrower.

A commercial real estate borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We generally require borrowers with aggregate outstanding balances exceeding \$1.0 million to provide annual updated financial statements and federal tax returns. These requirements also apply to all guarantors on these loans. We also require borrowers to provide an annual report of income and expenses for the property, including a tenant list and copies of leases, as applicable. The average commercial real estate loan in our portfolio at December 31, 2019 was approximately \$877,000, and the largest outstanding balance at that date was \$13.2 million.

**Commercial Loans.** Commercial loans totaled \$30.3 million at December 31, 2019, or 2.2% of total loans, and are made up of loans secured by accounts receivable, inventory, equipment and real estate. Commercial loans originated for investment during the year ended December 31, 2019 totaled \$7.5 million, or 2.3% of all loans originated.

Our commercial loans are generally made to borrowers that are located in our primary market area. Working capital lines of credit are granted for the purpose of carrying inventory and accounts receivable or purchasing equipment. These lines require that certain collateral levels must be maintained and are monitored on a monthly or quarterly basis. Working capital lines of credit are short-term loans of 12 months or less with variable interest rates. At December 31, 2019, the unadvanced portion of working capital lines of credit totaled \$17.0 million. Outstanding balances fluctuate up to the maximum commitment amount based on fluctuations in the balance of the underlying collateral. Personal property loans secured by equipment are considered commercial business loans and are generally made for terms of up to 84 months and for up to 80% of the value of the underlying collateral. Interest rates on equipment loans may be either fixed or variable. Commercial business loans are generally variable rate loans with initial fixed rate periods of up to five years.

A commercial business borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, usually quarterly, payment history reviews and periodic face-to-face meetings with the borrower. The average outstanding commercial loan at December 31, 2019 was \$238,000 and the largest outstanding balance on that date was \$6.3 million.

The following table shows loan origination, principal repayment activity, transfers to real estate owned, charge-offs and sales during the years indicated.

	<b>As of or for the Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	(In Thousands)		
Total gross loans receivable and held for sale at beginning of year	\$ 1,520,764	\$ 1,441,710	\$ 1,403,132
Real estate loans originated for investment:			
Residential			
One- to four-family	95,461	126,601	117,747
Multi-family	110,136	123,107	108,380
Home equity	5,804	4,613	5,430
Construction and land	59,814	66,265	2,270
Commercial real estate	49,710	58,176	61,684
Total real estate loans originated for investment	320,925	378,762	295,511
Consumer loans originated for investment	55	142	80
Commercial loans originated for investment	7,517	6,221	19,610
Total loans originated for investment	328,497	385,125	315,201
Principal repayments	(318,383)	(297,162)	(197,623)
Transfers to real estate owned	(1,052)	(545)	(2,171)
Loan principal charged-off	(179)	(84)	(1,477)
Net activity in loans held for investment	8,883	87,334	113,930
Loans originated for sale	2,853,222	2,509,827	2,458,370
Loans sold	(2,774,715)	(2,518,107)	(2,533,722)
Net activity in loans held for sale	78,507	(8,280)	(75,352)
Total gross loans receivable and held for sale at end of year	\$ 1,608,154	\$ 1,520,764	\$ 1,441,710

**Origination and Servicing of Loans.** All loans originated for investment are underwritten pursuant to internally developed policies and procedures. While we generally underwrite owner-occupied residential mortgage loans to Freddie Mac and Fannie Mae standards, due to several unique characteristics, our loans originated prior to 2008 do not conform to the secondary market standards. The unique features of these loans include interest payments in advance of the month in which they are earned and discretionary rate adjustments that are not tied to an independent index.

Exclusive of our mortgage banking operations, we retain in our portfolio all of the loans that we originate. At December 31, 2019, WaterStone Bank was not servicing any loan it originated and subsequently sold to unrelated third parties. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

**Loan Approval Procedures and Authority.** WaterStone Bank's lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by WaterStone Bank's board of directors. The loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan and the adequacy of the value of the property that will secure the loan, if applicable. To assess the borrower's ability to repay, we review the employment and credit history and information on the historical and projected income and expenses of borrowers.

Loan officers, with concurrence from independent credit officers and underwriters, are authorized to approve and close any loan that qualifies under WaterStone Bank underwriting guidelines within the following lending limits:

- A secured one- to four-family mortgage loan up to \$500,000 for a borrower with total outstanding loans from us of less than \$1.0 million that is independently underwritten can be approved by select loan officers.
- A loan up to \$500,000 for a borrower with total outstanding loans from us of less than \$500,000 can be approved by select commercial loan officers.
- Any secured mortgage loan ranging from \$500,001 to \$3.0 million or any new loan to a borrower with outstanding loans from us exceeding \$1.0 million must be approved by the Officer Loan Committee.
- Any non-real estate loan ranging from \$500,001 to \$3.0 million or any new non-real estate loan to a borrower with outstanding loans exceeding \$500,000 must be approved by the Officer Loan Committee.
- Any new loan over \$3.0 million must be approved by the Officer Loan Committee and the board of directors prior to closing. Any new loan to a borrower with outstanding loans from us exceeding \$10.0 million must be reviewed by the board of directors.

## **Asset Quality**

When a loan becomes more than 30 days delinquent, WaterStone Bank sends a letter advising the borrower of the delinquency. The borrower is given a specific date by which delinquent payments must be made or by which they must contact WaterStone Bank to make arrangements to bring the loan current over a longer period of time. If the borrower fails to bring the loan current within the specified time period or to make arrangements to cure the delinquency over a longer period of time, the matter is referred to legal counsel and foreclosure or other collection proceedings are considered.

All loans are reviewed on a regular basis, and loans are placed on non-accrual status when they become 90 or more days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is reversed, and further income is recognized only to the extent received when collection of the remaining principal balance is reasonably assured.

**Non-Performing Assets.** Non-performing assets consist of non-accrual loans and other real estate owned. Loans are generally placed on non-accrual status when contractually past due 90 days or more as to interest or principal payments. Additionally, whenever management becomes aware of facts or circumstances that may adversely impact the collectability of principal or interest on loans, management may place such loans on non-accrual status immediately, rather than waiting until the loan becomes 90 days past due. At the time a loan is placed on non-accrual status, previously accrued and uncollected interest on such loans is reversed and additional income is recorded only to the extent that payments are received and the collection of principal is reasonably assured. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The table below sets forth the amounts and categories of our non-accrual loans and real estate owned at the dates indicated.

	At December 31,				
	2019	2018	2017	2016	2015
	(Dollars in Thousands)				
Non-accrual loans:					
Residential					
One- to four-family	\$ 5,985	\$ 4,902	\$ 4,677	\$ 7,623	\$ 13,888
Multi-family	667	1,309	1,007	1,427	2,553
Home equity	70	201	107	344	437
Construction and land	-	-	-	-	239
Commercial real estate	303	125	251	422	460
Commercial	-	18	26	41	27
Consumer	-	-	-	-	-
Total non-accrual loans	<u>7,025</u>	<u>6,555</u>	<u>6,068</u>	<u>9,857</u>	<u>17,604</u>
Real estate owned					
One- to four-family	46	163	1,330	2,141	4,610
Multi-family	-	-	-	-	209
Construction and land	1,256	3,327	4,582	5,082	5,262
Commercial real estate	-	300	300	300	300
Total real estate owned	<u>1,302</u>	<u>3,790</u>	<u>6,212</u>	<u>7,523</u>	<u>10,381</u>
Valuation allowance at end of period	(554)	(1,638)	(1,654)	(1,405)	(1,191)
Total real estate owned, net	<u>748</u>	<u>2,152</u>	<u>4,558</u>	<u>6,118</u>	<u>9,190</u>
Total non-performing assets	<u>\$ 7,773</u>	<u>\$ 8,707</u>	<u>\$ 10,626</u>	<u>\$ 15,975</u>	<u>\$ 26,794</u>
Total non-accrual loans to total loans, net	0.51%	0.48%	0.47%	0.84%	1.58%
Total non-accrual loans to total assets	0.35%	0.34%	0.34%	0.55%	1.00%
Total non-performing assets to total assets	0.39%	0.45%	0.59%	0.89%	1.52%

All loans that meet or exceed 90 days with respect to past due principal and interest are recognized as non-accrual. Troubled debt restructurings which are still on non-accrual status either due to being past due 90 days or greater, or which have not yet performed under the modified terms for a reasonable period of time, are included in the table above. In addition, loans which are past due less than 90 days are evaluated to determine the likelihood of collectability given other credit risk factors such as early stage delinquency, the nature of the collateral or the results of a borrower fiscal review. When the collection of all contractual principal and interest is determined to be unlikely, the loan is moved to non-accrual status and an updated appraisal of the underlying collateral is ordered. This process generally takes place between 60 and 90 days past contractual due dates. Upon determining the updated estimated value of the collateral, a loan loss provision is recorded to establish a specific reserve to the extent that the outstanding principal balance exceeds the updated estimated net realizable value of the collateral. When a loan is determined to be uncollectible, generally coinciding with the initiation of foreclosure action, the specific reserve is reviewed for adequacy, adjusted if necessary, and charged-off.

The following table sets forth activity in our non-accrual loans for the years indicated.

	At and for the Year Ended December 31,				
	2019	2018	2017	2016	2015
	(Dollars in Thousands)				
Balance at beginning of year	\$ 6,555	\$ 6,068	\$ 9,857	\$ 17,604	\$ 38,011
Additions	3,716	3,147	3,149	3,114	10,165
Transfers to real estate owned	(1,052)	(545)	(2,171)	(4,590)	(15,580)
Charge-offs	(31)	(6)	(766)	(667)	(3,809)
Returned to accrual status	(650)	(777)	(2,716)	(4,183)	(5,824)
Principal paydowns	(1,513)	(1,332)	(1,285)	(1,421)	(5,359)
Balance at end of year	<u>\$ 7,025</u>	<u>\$ 6,555</u>	<u>\$ 6,068</u>	<u>\$ 9,857</u>	<u>\$ 17,604</u>

Total non-accrual loans increased by \$470,000, or 7.2%, to \$7.0 million as of December 31, 2019 compared to \$6.6 million as of December 31, 2018. The ratio of non-accrual loans to total loans receivable was 0.51% at December 31, 2019 compared to 0.48% at December 31, 2018. During the year ended December 31, 2019, \$1.1 million was transferred to real estate owned, \$31,000 in loan principal was charged off, \$1.5 million in principal payments were received and \$650,000 in loans were returned to accrual status. Offsetting this activity, \$3.7 million in loans were placed on non-accrual status during the year ended December 31, 2019.

Of the \$7.0 million in total non-accrual loans as of December 31, 2019, \$6.2 million in loans have been specifically reviewed to assess whether a specific valuation allowance is necessary. A specific valuation allowance is established for an amount equal to the impairment when the carrying value of the loan exceeds the present value of expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral with an adjustment made for costs to dispose of the asset. Based upon these specific reviews, a total of \$1.6 million in partial charge-offs have been recorded with respect to these loans as of December 31, 2019. Partially charged-off loans measured for impairment based upon net realizable collateral value are maintained in a "non-performing" status and are disclosed as impaired loans. In addition, specific reserves totaling \$39,000 have been recorded as of December 31, 2019. The remaining \$862,000 of non-accrual loans were reviewed on an aggregate basis and \$172,000 in general valuation allowance was deemed necessary related to those loans as of December 31, 2019. The \$172,000 in general valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

The outstanding principal balance of our five largest non-accrual loans as of December 31, 2019 totaled \$2.0 million, which represents 22.0% of total non-accrual loans as of that date. These five loans did not have any charge-offs or require any specific valuation allowances as of December 31, 2019.

For the year ended December 31, 2019, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$547,000. We received \$468,000 of interest payments on such loans during the year ended December 31, 2019. Interest payments received are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

There were no accruing loans past due 90 days or more during the years ended December 31, 2019, 2018 or 2017.

**Troubled Debt Restructurings.** The following table summarizes troubled debt restructurings by the Company's internal risk rating.

	At December 31,				
	2019	2018	2017	2016	2015
	(Dollars in Thousands)				
Troubled debt restructurings					
Substandard	\$ 4,018	\$ 4,256	\$ 5,035	\$ 7,025	\$ 14,436
Watch	-	2,476	47	3,112	3,103
Total troubled debt restructurings	<u>\$ 4,018</u>	<u>\$ 6,732</u>	<u>\$ 5,082</u>	<u>\$ 10,137</u>	<u>\$ 17,539</u>

Troubled debt restructurings totaled \$4.0 million at December 31, 2019, compared to \$6.7 million at December 31, 2018. At December 31, 2019, \$3.6 million of troubled debt restructurings, or 88.9%, were performing in accordance with their restructured terms. All troubled debt restructurings are considered to be impaired and are risk rated as either substandard or watch and are included in the internal risk rating tables disclosed in the notes to the consolidated financial statements. Specific reserves have been established to the extent that the collateral-based impairment analyses indicate that a collateral shortfall exists or to the extent that a discounted cash flow analysis results in an impairment.

We do not participate in government-sponsored troubled debt restructuring programs. Our troubled debt restructurings are short-term modifications. Typical initial restructured terms include six to twelve months of principal forbearance, a reduction in interest rate or both. Restructured terms do not include a reduction of the outstanding principal balance unless mandated by a bankruptcy court. Troubled debt restructuring terms may be renewed or further modified at the end of the initial term for an additional period if performance has been acceptable and the short-term borrower difficulty persists.

Information with respect to the accrual status of our troubled debt restructurings is provided in the following table.

	At December 31,			
	2019		2018	
	Accruing	Non-accruing	Accruing	Non-accruing
	(In Thousands)			
One- to four-family	\$ 2,740	\$ 685	\$ 2,740	\$ 844
Multi-family	-	308	-	372
Commercial real estate	278	7	2,759	17
	<u>\$ 3,018</u>	<u>\$ 1,000</u>	<u>\$ 5,499</u>	<u>\$ 1,233</u>

The following table sets forth activity in our troubled debt restructurings for the years indicated.

	At or for the Year Ended December 31,			
	2019		2018	
	Accruing	Non-accruing	Accruing	Non-accruing
	(In Thousands)			
Balance at beginning of year	\$ 5,499	\$ 1,233	\$ 3,077	\$ 2,005
Additions	-	-	2,476	-
Change in accrual status	-	-	-	-
Charge-offs	-	-	-	-
Returned to contractual/market terms	-	-	(46)	-
Transferred to real estate owned	-	-	-	-
Principal paydowns	(2,481)	(233)	(8)	(772)
Balance at end of period	<u>\$ 3,018</u>	<u>\$ 1,000</u>	<u>\$ 5,499</u>	<u>\$ 1,233</u>

For the year ended December 31, 2019, gross interest income that would have been recorded had our troubled debt restructurings been current in accordance with their contractual terms was \$338,000. We received \$310,000 of interest payments on such loans during the year ended December 31, 2019. Interest payments received on non-accrual troubled debt restructurings are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

If a restructured loan is current in all respects and a minimum of six consecutive restructured payments have been received, it can be considered for return to accrual status. After a restructured loan that is current in all respects reverts to contractual/market terms, if a credit department review indicates no evidence of elevated market risk, the loan is removed from the troubled debt restructuring classification. The restructured loan will be classified as a troubled debt restructuring for at least the calendar year after the modification even after returning to a contractual/market rate and accrual status.

**Loan Delinquency.** The following table summarizes loan delinquency in total dollars and as a percentage of the total loan portfolio:

	At December 31,	
	2019	2018
	(Dollars in Thousands)	
Loans past due less than 90 days	\$ 1,833	\$ 1,925
Loans past due 90 days or more	4,632	5,025
Total loans past due	<u>\$ 6,465</u>	<u>\$ 6,950</u>
Total loans past due to total loans receivable	0.47%	0.50%

Past due loans decreased by \$485,000, or 7.0%, to \$6.5 million at December 31, 2019 from \$7.0 million at December 31, 2018. Loans past due 90 days or more decreased by \$393,000, or 7.8%, and loans past due less than 90 days decreased by \$92,000, or 4.8%, during the year ended December 31, 2019. The \$485,000 decrease in loans past due was primarily due to a decrease in the multi family loans of \$577,000 during the year ended December 31, 2019.

**Potential Problem Loans.** We define potential problem loans as substandard loans which are still accruing interest. We do not necessarily expect to realize losses on potential problem loans, but we recognize potential problem loans carry a higher probability of default and require additional attention by management. The aggregate principal amounts of potential problem loans as of December 31, 2019 and 2018 were \$4.0 million and \$4.5 million, respectively. Management believes it has established an adequate allowance for probable loan losses as appropriate under generally accepted accounting principles.

**Real Estate Owned.** Total real estate owned decreased by \$1.4 million, or 65.2%, to \$748,000 at December 31, 2019, compared to \$2.2 million at December 31, 2018. During the year ended December 31, 2019, \$1.1 million was transferred from loans to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled \$2.4 million. There were no write-downs during the year ended December 31, 2019.

New appraisals received on real estate owned and collateral dependent impaired loans are based upon an "as is value" assumption. During the period of time in which we are awaiting receipt of an updated appraisal, loans evaluated for impairment based upon collateral value are measured by the following:

- Applying an updated adjustment factor to an existing appraisal;
- Confirming that the physical condition of the real estate has not significantly changed since the last valuation date;
- Comparing the estimated current value of the collateral to that of updated sales values experienced on similar collateral;
- Comparing the estimated current value of the collateral to that of updated values seen on current appraisals of similar collateral; and
- Comparing the estimated current value to that of updated listed sales prices on our real estate owned and that of similar properties (not owned by the Company).

We owned five properties at December 31, 2019, compared to 12 properties as of December 31, 2018 and 33 properties at December 31, 2017. Habitable real estate owned is managed with the intent of attracting a lessee to generate revenue. Foreclosed properties are transferred to real estate owned at estimated net realizable value, with charge-offs, if any, charged to the allowance for loan losses upon transfer to real estate owned. The fair value is primarily based upon updated appraisals in addition to an analysis of current real estate market conditions.

#### **Allowance for Loan Losses**

We establish valuation allowances on loans that are deemed to be impaired. A loan is considered impaired when, based on current information and events, it is probable that we will not be able to collect all amounts due according to the contractual terms of the loan agreement. A valuation allowance is established for an amount equal to the impairment when the carrying amount of the loan exceeds the present value of the expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral.

We also establish valuation allowances based on an evaluation of the various risk components that are inherent in the loan portfolio. The risk components that are evaluated include past loan loss experience; the level of non-performing and classified assets; current economic conditions; volume, growth, and composition of the loan portfolio; adverse situations that may affect the borrower's ability to repay; the estimated value of any underlying collateral; regulatory guidance; and other relevant factors. The allowance is increased by provisions charged to earnings and recoveries of previously charged-off loans and reduced by charge-offs. The appropriateness of the allowance for loan losses is reviewed and approved quarterly by the WaterStone Bank board of directors. The allowance reflects management's best estimate of the amount needed to provide for the probable loss on impaired loans and other inherent losses in the loan portfolio, and is based on a risk model developed and implemented by management and approved by the WaterStone Bank board of directors.

Actual results could differ from this estimate, and future additions to the allowance may be necessary based on unforeseen changes in loan quality and economic conditions. In addition, the Federal Deposit Insurance Corporation and the WDFI, as an integral part of their examination process, periodically review WaterStone Bank's allowance for loan losses. Such regulators have the authority to require WaterStone Bank to recognize additions to the allowance based on their judgments of information available to them at the time of their review or examination.

Any loan that is 90 or more days past due is placed on non-accrual and classified as a non-performing loan. A loan is classified as impaired when it is probable that we will be unable to collect all amounts due in accordance with the terms of the loan agreement. Non-performing loans are then evaluated and accounted for in accordance with generally accepted accounting principles.

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

	<b>At or for the Year Ended December 31,</b>				
	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
	(Dollars in Thousands)				
Balance at beginning of year	\$ 13,249	\$ 14,077	\$ 16,029	\$ 16,185	\$ 18,706
Provision (credit) for loan losses	(900)	(1,060)	(1,166)	380	1,965
Charge-offs:					
Mortgage loans					
One- to four-family	125	69	1,364	1,003	3,855
Multi-family	3	14	92	489	2,281
Home equity	44	1	-	112	72
Construction and land	-	-	14	3	84
Commercial real estate	2	-	7	-	45
Consumer	5	-	-	-	3
Commercial	-	-	-	-	-
Total charge-offs	<u>179</u>	<u>84</u>	<u>1,477</u>	<u>1,607</u>	<u>6,340</u>
Recoveries:					
Mortgage loans					
One- to four-family	135	159	293	811	649
Multi-family	30	89	208	152	992
Home equity	27	26	26	36	110
Construction and land	-	40	162	72	58
Commercial real estate	25	2	1	-	40
Consumer	-	-	1	-	5
Commercial	-	-	-	-	-
Total recoveries	<u>217</u>	<u>316</u>	<u>691</u>	<u>1,071</u>	<u>1,854</u>
Net (recoveries) charge-offs	(38)	(232)	786	536	4,486
Allowance at end of year	<u>\$ 12,387</u>	<u>\$ 13,249</u>	<u>\$ 14,077</u>	<u>\$ 16,029</u>	<u>\$ 16,185</u>
Ratios:					
Allowance for loan losses to non-performing loans at end of year	176.33%	202.12%	231.99%	162.62%	91.94%
Allowance for loan losses to loans outstanding at end of year	0.89%	0.96%	1.09%	1.36%	1.45%
Net (recoveries) charge-offs to average loans outstanding	(0.00%)	(0.02%)	0.06%	0.05%	0.37%
Current year provision (credit) for loan losses to net (recoveries) charge-offs	2,368.42%	456.90%	(148.35%)	70.90%	43.80%
Net (recoveries) charge-offs to beginning of the year allowance	(0.29%)	(1.65%)	4.90%	3.31%	23.98%



**Allocation of Allowance for Loan Losses.** The following table sets forth the allowance for loan losses allocated by loan category, the total loan balances by category, and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	At December 31,								
	2019			2018			2017		
	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance
(Dollars in Thousands)									
Real Estate:									
Residential									
One- to four-family	\$ 4,907	34.60%	39.61%	\$ 5,742	35.53%	43.34%	\$ 5,794	34.03%	41.16%
Multi-family	4,138	42.14%	33.41%	4,153	43.29%	31.35%	4,431	44.77%	31.48%
Home equity	201	1.30%	1.62%	325	1.45%	2.45%	356	1.64%	2.53%
Construction and land	610	2.67%	4.92%	400	0.97%	3.02%	949	1.54%	6.74%
Commercial real estate	2,145	17.05%	17.32%	2,126	16.35%	16.05%	1,881	15.16%	13.36%
Commercial	372	2.18%	3.00%	483	2.38%	3.65%	656	2.84%	4.66%
Consumer	14	0.06%	0.11%	20	0.03%	0.15%	10	0.02%	0.07%
Total allowance for loan losses	<u>\$ 12,387</u>	<u>100.00%</u>	<u>100.00%</u>	<u>\$ 13,249</u>	<u>100.00%</u>	<u>100.00%</u>	<u>\$ 14,077</u>	<u>100.00%</u>	<u>100.00%</u>

	At December 31,					
	2016			2015		
	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance
(Dollars In Thousands)						
Real Estate:						
Residential						
One- to four-family	\$ 7,164	33.35%	44.69%	\$ 7,763	34.26%	47.96%
Multi-family	4,809	47.42%	30.00%	5,000	49.08%	30.89%
Home equity	364	1.85%	2.27%	433	2.18%	2.68%
Construction and land	1,016	1.54%	6.34%	904	1.72%	5.59%
Commercial real estate	1,951	13.53%	12.17%	1,680	10.66%	10.38%
Commercial	713	2.28%	4.45%	396	2.07%	2.45%
Consumer	12	0.03%	0.07%	9	0.03%	0.06%
Total allowance for loan losses	<u>\$ 16,029</u>	<u>100.00%</u>	<u>100.00%</u>	<u>\$ 16,185</u>	<u>100.00%</u>	<u>100.00%</u>

All impaired loans meeting the criteria established by management are evaluated individually, based primarily on the value of the collateral securing each loan and the ability of the borrowers to repay according to the terms of the loans, or based upon an analysis of the present value of the expected future cash flows under the original contract terms as compared to the modified terms in the case of certain troubled debt restructurings. Specific loss allowances are established as required by this analysis. At least once each quarter, management evaluates the appropriateness of the balance of the allowance for loan losses based on several factors some of which are not loan specific, but are reflective of the inherent losses in the loan portfolio. This process includes, but is not limited to, a periodic review of loan collectability in light of historical experience, the nature and volume of loan activity, conditions that may affect the ability of the borrower to repay, underlying value of collateral and economic conditions in our immediate market area. All loans for which a specific loss review is not required are segregated by loan type and a loss allowance is established by using loss experience data and management's judgment concerning other matters it considers significant including trends in non-performing loan balances, impaired loan balances, classified asset balances and the current economic environment. The allowance is allocated to each category of loans based on the results of the above analysis.

Our underwriting policies and procedures emphasize that credit decisions must rely on both the credit quality of the borrower and the estimated value of the underlying collateral. Credit quality is assured only when the estimated value of the collateral is objectively determined and is not subject to significant fluctuation.

The allowance for loan losses has been determined in accordance with generally accepted accounting principals (GAAP). We are responsible for the timely and periodic determination of the amount of the allowance required. Any future provisions for loan losses will continue to be based upon our assessment of the overall loan portfolio and the underlying collateral, trends in non-performing loans, current economic conditions and other relevant factors. To the best of management's knowledge, all probable losses have been provided for in the allowance for loan losses.

The establishment of the amount of the loan loss allowance inherently involves judgments by management as to the appropriateness of the allowance, which ultimately may or may not be correct. Higher than anticipated rates of loan default would likely result in a need to increase provisions in future years.

At December 31, 2019, the allowance for loan losses was \$12.4 million, compared to \$13.2 million at December 31, 2018. As of December 31, 2019, the allowance for loan losses to total loans receivable was 0.89% and 176.33% of non-performing loans, compared to 0.96%, and 202.12%, respectively at December 31, 2018. The decrease in the allowance for loan losses during the year ended December 31, 2019 reflects a continued stabilization in the quality of the loan portfolio and continued improvement in the overall risk profile of the loan portfolio.

Net recoveries totaled \$38,000, or less than 0.01% of average loans for the year ended December 31, 2019, compared to net recoveries \$232,000, or 0.02% of average loans for the year ended December 31, 2018. The \$194,000 decrease in net recoveries was primarily the result of an increase in charge-offs in the one- to four-family and home equity loan categories offset primarily by an increase in recoveries for the commercial real estate loan category. Net recoveries related to loans secured by one- to four-family residential loans decreased \$80,000, to \$10,000 in net recoveries for year ended December 31, 2019, as compared to net recoveries of \$90,000 for the year ended December 31, 2018. Net recoveries related to loans secured by multi-family loans decreased \$48,000 to net recoveries of \$27,000 for year ended December 31, 2019, as compared to net recoveries of \$75,000 for the year ended December 31, 2018. Net charge-offs related to loans secured by home equity loans increased \$42,000, to net charge-offs of \$17,000 for year ended December 31, 2019, as compared to net recoveries of \$25,000 for the year ended December 31, 2018. Net recoveries related to loans secured by construction and land loans decreased \$40,000 to no net recoveries for year ended December 31, 2019, as compared to recoveries of \$40,000 for the year ended December 31, 2018. Partially offsetting the increases in net charge-offs, net recoveries related to loans secured by commercial real estate loans increased \$21,000, to net recoveries of \$23,000 for year ended December 31, 2019, as compared to net recoveries of \$2,000 for the year ended December 31, 2018.

### **Mortgage Banking Activity**

In addition to the lending activities previously discussed, we also originate single-family residential mortgage loans for sale in the secondary market through Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originated \$2.92 billion in mortgage loans held for sale during the year ended December 31, 2019, which was an volume increase of \$324.5 million, or 12.5%, from the \$2.60 billion originated during the year ended December 31, 2018. The increase in loan production volume was driven by a 122.9% volume increase in refinance products and 1.0% increase in mortgage purchase products. Total mortgage banking income increased \$11.5 million, or 9.9%, to \$126.9 million during the year ended December 31, 2019 compared to \$115.4 million during the year ended December 31, 2018. Offsetting the increase in the volume of loans originated and sold, gross margin on those loans originated and sold decreased approximately 1.9% for the year ended December 31, 2019 compared to December 31, 2018. Gross margin on those loans originated and sold is the ratio of mortgage banking income (excluding the change in interest rate lock fair value) divided by total loan originations. We sell loans on both a servicing-released and a servicing retained basis. Waterstone Mortgage Corporation has contracted with a third party to service the loans for which we retain servicing.

Our gross margin can be affected by the mix of both loan type (conventional loans versus governmental) and loan purpose (purchase versus refinance). Conventional loans include loans that conform to Fannie Mae and Freddie Mac standards, whereas governmental loans are those loans guaranteed by the federal government, such as a Federal Housing Authority or U.S. Department of Agriculture loan. Loans originated for the purchase of a residential property, which generally yield a higher margin than loans originated for refinancing existing loans, comprised 81.4% of total originations during the year ended December 31, 2019, compared to 90.6% of total originations during the year ended December 31, 2018. The mix of loan type trended towards more governmental loans and less conventional loans comprising 30.5% and 69.5% of all loan originations, respectively, during the year ended December 31, 2019, compared to 30.3% and 69.7% of all loan originations, respectively, during the year ended December 31, 2018.

### **Investment Activities**

Wauwatosa Investments, Inc. is WaterStone Bank's investment subsidiary headquartered in the State of Nevada. Wauwatosa Investments, Inc. manages the back office function for WaterStone Bank's investment portfolio. Our Chief Financial Officer and Treasury Officer are responsible for executing purchases and sales in accordance with our investment policy and monitoring the investment activities of Wauwatosa Investments, Inc. The investment policy is reviewed annually by management and changes to the policy are recommended to and subject to the approval of WaterStone Bank's board of directors. Authority to make investments under the approved investment policy guidelines is delegated by the board to designated employees. While general investment strategies are developed and authorized by management, the execution of specific actions rests with the Chief Financial Officer and Treasury Officer who may act jointly in performing security trades. The Chief Financial Officer and Treasury Officer are responsible for ensuring that the guidelines and requirements included in the investment policy are followed and that all securities are considered prudent for investment. The Chief Financial Officer and the Treasury Officer are authorized to execute investment transactions (purchases and sales) without the prior approval of the board provided they are within the scope of the established investment policy.

Our investment policy requires that all securities transactions be conducted in a safe and sound manner. Investment decisions are based upon a thorough analysis of each security instrument to determine its quality, inherent risks, fit within our overall asset/liability management objectives, effect on our risk-based capital measurement and prospects for yield and/or appreciation.

Consistent with our overall business and asset/liability management strategy, which focuses on sustaining adequate levels of core earnings, our investment portfolio is comprised primarily of securities that are classified as available for sale. During the years ended December 31, 2019 and 2018, no investment securities were sold. During the year ended December 31, 2017, one municipal security with a total book value of \$555,000 was sold at a loss of \$107,000.

## Available for Sale Portfolio

***Mortgage-backed Securities and Collateralized Mortgage Obligations.*** We purchase mortgage-backed securities and collateralized mortgage obligations guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae. We invest in mortgage-backed securities and collateralized mortgage obligations to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk. We regularly monitor the credit quality of this portfolio.

Mortgage-backed securities and collateralized mortgage obligations are created by the pooling of mortgages and the issuance of a security. These securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although we focus our investments on mortgage related securities backed by one- to four-family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as WaterStone Bank, and in the case of government agency sponsored issues, guarantee the payment of principal and interest to investors. Mortgage-backed securities and collateralized mortgage obligations generally yield less than the loans that underlie such securities because of the cost of payment guarantees, if any, and credit enhancements. These fixed-rate securities are usually more liquid than individual mortgage loans.

At December 31, 2019, mortgage-backed securities totaled \$34.2 million. The mortgage-backed securities portfolio had a weighted average yield of 2.59% and a weighted average remaining life of 4.6 years at December 31, 2019. The estimated fair value of our mortgage-backed securities portfolio at December 31, 2019 was \$377,000 greater than the amortized cost of \$33.8 million. Mortgage-backed securities valued at \$1.2 million were pledged as collateral for mortgage banking activities as of December 31, 2019. Investments in mortgage-backed securities involve a risk that actual prepayments may differ from estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or if such securities are redeemed by the issuer. In addition, the fair value of such securities may be adversely affected in a rising interest rate environment, particularly since all of our mortgage-backed securities have a fixed rate of interest. The relatively short weighted average remaining life of our mortgage-backed security portfolio mitigates our potential risk of loss in a rising interest rate environment.

At December 31, 2019, collateralized mortgage obligations totaled \$81.8 million. At December 31, 2019, the collateralized mortgage obligations portfolio consisted entirely of securities backed by government sponsored enterprises or U.S. Government agencies. The collateralized mortgage obligations portfolio had a weighted average yield of 2.64% and a weighted average remaining life of 3.1 years at December 31, 2019. The estimated fair value of our collateralized mortgage obligations portfolio at December 31, 2019 was \$522,000 greater than the amortized cost of \$81.2 million. Investments in collateralized mortgage obligations involve a risk that actual prepayments may differ from estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or if such securities are redeemed by the issuer. In addition, the fair value of such securities may be adversely affected in a rising interest rate environment, particularly since all of our collateralized mortgage obligations have a fixed rate of interest. The relatively short weighted average remaining life of our collateralized mortgage obligation portfolio mitigates our potential risk of loss in a rising interest rate environment.

***Municipal Obligations.*** These securities consist of obligations issued by school districts, counties and municipalities or their agencies and include general obligation bonds, industrial development revenue bonds and other revenue bonds. Our investment policy requires that such municipal obligations be rated A+ or better by a nationally recognized rating agency at the date of purchase. A security that is downgraded below investment grade will require additional analysis of creditworthiness and a determination will be made to hold or dispose of the investment. We regularly monitor the credit quality of this portfolio. At December 31, 2019, our municipal obligations portfolio totaled \$53.7 million, all of which was classified as available for sale. The weighted average yield on this portfolio was 3.10% at December 31, 2019, with a weighted average remaining life of 4.3 years. The estimated fair value of our municipal obligations bond portfolio at December 31, 2019 was \$1.8 million greater than the amortized cost of \$51.9 million.

As of December 31, 2019, the Company identified one municipal security that was deemed to be other-than-temporarily impaired. The security was issued by a tax incremental district in a municipality located in Wisconsin. During the year ended December 31, 2012, the Company received audited financial statements with respect to the municipal issuer that called into question the ability of the underlying taxing district that issued the securities to operate as a going concern. During the year ended December 31, 2012, the Company's analysis of the security in this municipality resulted in \$77,000 in credit losses that were charged to earnings with respect to this municipal security. An additional \$17,000 credit loss was charged to earnings during the year ended December 31, 2014 with respect to this security as a sale occurred at a discounted price. As of December 31, 2019, the remaining impaired bond had an amortized cost of \$116,000 and a total life-to-date impairment of \$94,000.

***Other Debt Securities.*** As of December 31, 2019, we held other debt securities with a fair value of \$8.9 million and amortized cost of \$10.0 million. Other debt securities consists of one corporate bond. The weighted average yield on this portfolio was 1.39% at December 31, 2019, with a weighted average remaining life of 10.3 years. We regularly monitor the credit quality of this portfolio.

**Investment Securities Portfolio.**

The following table sets forth the carrying values of our available for sale securities portfolio at the dates indicated.

	At December 31,					
	2019		2018		2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)					
Securities available for sale:						
Mortgage-backed securities	\$ 33,773	\$ 34,150	\$ 42,105	\$ 41,631	\$ 57,351	\$ 57,435
Collateralized mortgage obligations						
Government sponsored enterprise issued	81,232	81,754	75,923	74,955	61,313	60,500
Government sponsored enterprise bonds	-	-	-	-	2,500	2,497
Municipal obligations	51,898	53,692	55,242	55,948	62,516	63,769
Other debt securities	10,000	8,880	15,002	13,186	15,005	14,525
Certificates of deposit	-	-	-	-	980	981
Total securities available for sale	<u>\$ 176,903</u>	<u>\$ 178,476</u>	<u>\$ 188,272</u>	<u>\$ 185,720</u>	<u>\$ 199,665</u>	<u>\$ 199,707</u>

The following table sets forth, by issuer, the amortized cost and estimated fair value of our investments in a single issuer, as of December 31, 2019, that exceeded 10% of our stockholders' equity as of that date.

	At December 31, 2019	
	Amortized Cost	Fair Value
	(In Thousands)	
Fannie Mae	\$ 67,644	\$ 68,166
Freddie Mac	39,549	39,874

**Portfolio Maturities and Yields.** The composition and maturities of the securities portfolio at December 31, 2019 are summarized in the following table. Maturities are based on the final contractual payment dates and do not reflect the impact of prepayments or early redemptions that may occur. Municipal obligation yields have not been adjusted to a tax-equivalent basis. Certain mortgage related securities have interest rates that are adjustable and will reprice annually within the various maturity ranges. These repricing schedules are not reflected in the table below.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities	
	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)									
Securities available for sale:										
Mortgage-backed securities	\$ 1,311	2.97%	\$ 25,606	2.47%	\$ 1,472	2.75%	\$ 5,384	3.03%	\$ 33,773	2.59%
Collateralized mortgage obligations										
Government sponsored enterprise issued	815	2.24%	76,309	2.63%	4,108	2.79%	-	-	81,232	2.64%
Municipal obligations	3,449	2.18%	33,200	2.94%	14,615	3.71%	634	5.51%	51,898	3.10%
Other debt securities	-	-	-	-	-	-	10,000	1.39%	10,000	1.39%
Total securities available for sale	<u>\$ 5,575</u>	2.38%	<u>\$ 135,115</u>	2.68%	<u>\$ 20,195</u>	3.45%	<u>\$ 16,018</u>	2.10%	<u>\$ 176,903</u>	2.70%

## Sources of Funds

**General.** Deposits have traditionally been our primary source of funds for use in lending and investment activities. We also rely on advances from the Federal Home Loan Bank of Chicago and borrowings from other commercial banks in the form of repurchase agreements collateralized by investment securities. In addition to deposits and borrowings, we derive funds from scheduled loan payments, investment maturities, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing market interest rates, economic conditions and competition from other financial institutions.

**Deposits.** A majority of our depositors are persons or businesses who work, reside, or are located in Milwaukee and Waukesha Counties and, to a lesser extent, other southeastern Wisconsin communities. We offer a selection of deposit instruments, including checking, savings, money market deposit accounts, and fixed-term certificates of deposit. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. As of December 31, 2019, certificates of deposit comprised 69.3% of total customer deposits, and had a weighted average cost of 2.18% on that date. Our reliance on certificates of deposit has resulted in a higher cost of funds than would otherwise be the case if demand deposits, savings and money market accounts made up a larger part of our deposit base. Development of our branch network and expansion of our commercial products and services and aggressively seeking lower cost savings, checking and money market accounts are expected to result in decreased reliance on higher-cost certificates of deposit.

Interest rates paid, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market rates, liquidity requirements, rates paid by competitors and growth goals. To attract and retain deposits, we rely upon personalized customer service, long-standing relationships and competitive interest rates. We also provide remote deposit capture, internet banking and mobile banking.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and other prevailing interest rates and competition. The variety of deposit accounts that we offer allows us to be competitive in obtaining funds and responding to changes in consumer demand. Based on historical experience, management believes our deposits are relatively stable. The ability to attract and maintain money market accounts and certificates of deposit, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions. At December 31, 2019 and December 31, 2018, \$739.8 million and \$735.9 million of our deposit accounts were certificates of deposit, of which \$665.7 million and \$472.5 million, respectively, had remaining maturities of one year or less.

Deposits increased by \$29.3 million, or 2.8%, from December 31, 2018 to December 31, 2019. The increase in deposits was the result of a \$25.4 million, or 8.4%, increase in total transaction accounts and a \$3.9 million, or 0.5% increase in time deposits. The Company had no deposits obtained directly from brokers as of December 31, 2019 and December 31, 2018.

The following table sets forth the distribution of total deposit accounts, by account type, at the dates indicated.

	At December 31,								
	2019			2018			2017		
	Average Balance	Average Cost of Funds	Ending Weighted Average Yield	Average Balance	Average Cost of Funds	Ending Weighted Average Yield	Average Balance	Average Cost of Funds	Ending Weighted Average Yield
	(Dollars in Thousands)								
Deposit type:									
Demand deposits	\$ 90,497	0.00%	0.00%	\$ 96,648	0.00%	0.00%	\$ 89,785	0.00%	0.00%
NOW accounts	36,926	0.09%	0.07%	37,388	0.09%	0.07%	36,716	0.08%	0.08%
Savings and escrow	72,872	0.05%	0.04%	77,454	0.04%	0.04%	78,788	0.04%	0.04%
Money market	125,155	0.97%	1.05%	95,306	0.60%	0.38%	92,519	0.40%	0.31%
Total transaction accounts	325,450	0.39%	0.47%	306,796	0.21%	0.15%	297,808	0.14%	0.12%
Certificates of deposit	737,397	2.17%	2.18%	709,102	1.55%	2.01%	671,982	1.09%	1.31%
Total deposits	\$ 1,062,847	1.62%	1.65%	\$ 1,015,898	1.15%	1.46%	\$ 969,790	0.80%	0.96%

At December 31, 2019, the aggregate balance of certificates of deposit of \$100,000 or more was \$299.6 million. The following table sets forth the maturity of those certificates at December 31, 2019.

Due in:	(In Thousands)
Three months or less	\$ 61,876
Over three months through six months	56,942
Over six months through 12 months	152,154
Over 12 months	28,589
<b>Total</b>	<b>\$ 299,561</b>

**Borrowings.** Our borrowings at December 31, 2019 consisted of \$470.0 million in advances from the Federal Home Loan Bank of Chicago and \$13.6 million outstanding balance in short-term repurchase agreements used to fund loans held for sale. The following table sets forth information concerning balances and interest rates on borrowings at the dates and for the periods indicated.

	At or For the Year Ended December 31,		
	2019	2018	2017
	(Dollars in Thousands)		
<b>Borrowings:</b>			
Balance outstanding at end of year	\$ 483,562	\$ 435,046	\$ 386,285
Weighted average interest rate at the end of year	2.11%	2.01%	1.57%
Maximum amount of borrowings outstanding at any month end during the year	\$ 519,396	\$ 451,132	\$ 498,103
Average balance outstanding during the year	\$ 484,801	\$ 427,301	\$ 403,163
Weighted average interest rate during the year	2.12%	1.85%	2.14%

## Personnel

As of December 31, 2019, we had 824 full-time equivalent employees. A total of 197 are WaterStone Bank employees and 627 are employees of Waterstone Mortgage Corporation. Our employees are not represented by any collective bargaining group. Management believes that we have good working relations with our employees.

## Supervision and Regulation

### General

WaterStone Bank is a stock savings bank organized under the laws of the State of Wisconsin. The lending, investment, and other business operations of WaterStone Bank are governed by Wisconsin law and regulations, as well as applicable federal law and regulations, and WaterStone Bank is prohibited from engaging in any operations not authorized by such laws and regulations. WaterStone Bank is subject to extensive regulation, supervision and examination by the WDFI and by the Federal Deposit Insurance Corporation. This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the Federal Deposit Insurance Corporation's deposit insurance fund and depositors, and not for the protection of security holders. WaterStone Bank also is regulated to a lesser extent by the Federal Reserve Board, governing reserves to be maintained against deposits and other matters. WaterStone Bank also is a member of and owns stock in the Federal Home Loan Bank of Chicago, which is one of the 11 regional banks in the Federal Home Loan Bank System.

Under this system of regulation, the regulatory authorities have extensive discretion in connection with their supervisory, enforcement, rulemaking and examination activities and policies, including rules or policies that: establish minimum capital levels; restrict the timing and amount of dividend payments; govern the classification of assets; determine the adequacy of loan loss reserves for regulatory purposes; and establish the timing and amounts of assessments and fees. Moreover, as part of their examination authority, the banking regulators assign numerical ratings to banks and savings institutions relating to capital, asset quality, management, liquidity, earnings and other factors. These ratings are inherently subjective and the receipt of a less than satisfactory rating in one or more categories may result in enforcement action by the banking regulators against a financial institution. A less than satisfactory rating may also prevent a financial institution, such as WaterStone Bank or its holding company, from obtaining necessary regulatory approvals to access the capital markets, pay dividends, acquire other financial institutions or establish new branches.

In addition, we must comply with significant anti-money laundering and anti-terrorism laws and regulations, Community Reinvestment Act laws and regulations, and fair lending laws and regulations. Government agencies have the authority to impose monetary penalties and other sanctions on institutions that fail to comply with these laws and regulations, which could significantly affect our business activities, including our ability to acquire other financial institutions or expand our branch network.

As a savings and loan holding company, Waterstone Financial is required to comply with the rules and regulations of the Federal Reserve Board. It is required to file certain reports with the Federal Reserve Board and is subject to examination by and the enforcement authority of the Federal Reserve Board. Waterstone Financial is also subject to the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Any change in applicable laws or regulations, whether by the WDFI, the Federal Deposit Insurance Corporation, the Federal Reserve Board or Congress, could have a material adverse impact on the operations and financial performance of Waterstone Financial, WaterStone Bank and Waterstone Mortgage Corporation.

Set forth below is a brief description of material regulatory requirements that are or will be applicable to WaterStone Bank, Waterstone Mortgage Corporation and Waterstone Financial. The description is limited to certain material aspects of the statutes and regulations addressed, and is not intended to be a complete description of such statutes and regulations and their effects on WaterStone Bank, Waterstone Mortgage Corporation and Waterstone Financial.

#### ***Intrastate and Interstate Merger and Branching Activities***

*Wisconsin Law and Regulation.* Any Wisconsin savings bank meeting certain requirements may, upon approval of the WDFI, establish one or more branch offices in the state of Wisconsin and the states of Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, and Ohio. In addition, upon WDFI approval, a Wisconsin savings bank may establish a branch office in any other state as the result of a merger or consolidation.

*Federal Law and Regulation.* The Interstate Banking Act permits the federal banking agencies to, under certain circumstances, approve acquisition transactions between banks located in different states, regardless of whether an acquisition would be prohibited under state law. The Interstate Banking Act, as amended, authorizes *de novo* branching into another state at locations at which banks chartered by the host state could establish a branch.

#### ***Loans and Investments***

*Wisconsin Law and Regulations.* Under Wisconsin law and regulation, WaterStone Bank is authorized to make, invest in, sell, purchase, participate or otherwise deal in mortgage loans or interests in mortgage loans without geographic restriction, including loans made on the security of residential and commercial property. Wisconsin savings banks also may lend funds on a secured or unsecured basis for business, commercial or agricultural purposes, provided the total of all such loans does not exceed 20% of the savings bank's total assets, unless the WDFI authorizes a greater amount. Loans are subject to certain other limitations, including percentage restrictions based on total assets.

Wisconsin savings banks may invest funds in certain types of debt and equity securities, including obligations of federal, state and local governments and agencies. Subject to prior approval of the WDFI, compliance with capital requirements and certain other restrictions, Wisconsin savings banks may invest in residential housing development projects. Wisconsin savings banks may also invest in service corporations or subsidiaries with the prior approval of the WDFI, subject to certain restrictions. Similarly, the line of credit that WaterStone Bank provides to Waterstone Mortgage Corporation is subject to the approval of the WDFI.

Wisconsin savings banks may make loans and extensions of credit, both direct and indirect, to one borrower in amounts up to 20% of the savings bank's capital plus an additional 5% for loans fully secured by readily marketable collateral. In addition, and notwithstanding the 20% of capital and additional 5% of capital limitations set forth above, Wisconsin savings banks may make loans to one borrower, or a related group of borrowers, for any purpose in an amount not to exceed \$500,000, or to develop domestic residential housing units in an amount not to exceed the lesser of \$30 million or 30% of the savings bank's capital, subject to certain conditions. At December 31, 2019, WaterStone Bank did not have any loans which exceeded the "loans-to-one borrower" limitations.

In addition, under Wisconsin law, WaterStone Bank must qualify for and maintain a level of qualified thrift investments equal to 60% of its assets as prescribed in Section 7701(a)(19) of the Internal Revenue Code of 1986, as amended. A Wisconsin savings bank that fails to meet this qualified thrift lender test becomes subject to certain operating restrictions otherwise applicable only to commercial banks. At December 31, 2019, WaterStone Bank maintained 86.7% of its assets in qualified thrift investments and therefore met the qualified thrift lender requirement.

*Federal Law and Regulation.* Federal Deposit Insurance Corporation regulations also govern the equity investments of WaterStone Bank and, notwithstanding Wisconsin law and regulations, Federal Deposit Insurance Corporation regulations prohibit WaterStone Bank from making certain equity investments and generally limit WaterStone Bank's equity investments to those that are permissible for national banks and their subsidiaries. Under Federal Deposit Insurance Corporation regulations, WaterStone Bank must obtain prior Federal Deposit Insurance Corporation approval before directly, or indirectly through a majority-owned subsidiary, engaging "as principal" in any activity that is not permissible for a national bank unless certain exceptions apply. The activity regulations provide that state banks that meet applicable minimum capital requirements would be permitted to engage in certain activities that are not permissible for national banks, including certain real estate and securities activities conducted through subsidiaries. The Federal Deposit Insurance Corporation will not approve an activity that it determines presents a significant risk to the Federal Deposit Insurance Corporation insurance fund. The current activities of WaterStone Bank and its subsidiaries are permissible under applicable federal regulations.

Loans to, and other transactions with, affiliates of WaterStone Bank, such as Waterstone Financial, are restricted by the Federal Reserve Act and regulations issued by the Federal Reserve Board thereunder. See "—Transactions with Affiliates and Insiders" below.

## ***Lending Standards***

*Wisconsin Law and Regulation.* Wisconsin law and regulations issued by the WDFI impose on Wisconsin savings banks certain fairness in lending requirements and prohibit savings banks from discriminating against a loan applicant based upon the applicant's physical condition, developmental disability, sex, marital status, race, color, creed, national origin, religion or ancestry.

*Federal Law and Regulation.* The federal banking agencies have adopted uniform regulations prescribing standards for extensions of credit that are secured by liens on interests in real estate or made for the purpose of financing the construction of a building or other improvements to real estate. Under the joint regulations adopted by the federal banking agencies, all insured depository institutions, such as WaterStone Bank, must adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens or interests in real estate or are made for the purpose of financing permanent improvements to real estate. These policies must establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value limits) that are clear and measurable, loan administration procedures, and loan documentation, approval and reporting requirements. The real estate lending policies must reflect consideration of the Interagency Guidelines for Real Estate Lending Policies that have been adopted by the federal bank regulators.

The Interagency Guidelines, among other things, require a depository institution to establish internal loan-to-value limits for real estate loans that are not in excess of the following supervisory limits:

- for loans secured by raw land, the supervisory loan-to-value limit is 65% of the value of the collateral;
- for land development loans (i.e., loans for the purpose of improving unimproved property prior to the erection of structures), the supervisory limit is 75%;
- for loans for the construction of commercial, over four-family or other non-residential property, the supervisory limit is 80%;
- for loans for the construction of one- to four-family properties, the supervisory limit is 85%; and
- for loans secured by other improved property (e.g., farmland, completed commercial property and other income-producing property, including non-owner occupied, one- to four-family property), the limit is 85%.

Although no supervisory loan-to-value limit has been established for permanent mortgages on owner-occupied, one- to four-family and home equity loans, the Interagency Guidelines state that for any such loan with a loan-to-value ratio that equals or exceeds 90% at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

## ***Deposits***

*Wisconsin Law and Regulation.* Under Wisconsin law, WaterStone Bank is permitted to establish deposit accounts and accept deposits. WaterStone Bank's board of directors, or its designee, determines the rate and amount of interest to be paid on or credited to deposit accounts subject to Federal Deposit Insurance Corporation limitations.

## ***Deposit Insurance***

*Wisconsin Law and Regulation.* Under Wisconsin law, WaterStone Bank is required to obtain and maintain insurance on its deposits from a deposit insurance corporation. The deposits of WaterStone Bank are insured up to the applicable limits by the Federal Deposit Insurance Corporation.

*Federal Law and Regulation.* WaterStone Bank is a member of the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation, generally up to a maximum of \$250,000.

The Federal Deposit Insurance Corporation imposes an assessment against all insured depository institutions. An institution's assessment rate depends upon the perceived risk of the institution to the Deposit Insurance Fund, with less risky institutions paying lower rates. Currently, assessments for institutions of less than \$10 billion of total assets are based on financial measures and supervisory ratings derived from statistical models estimating the probability of failure within three years. Assessment rates (inclusive of possible adjustments) currently range from 1.5 to 30 basis points of each institution's total assets less tangible capital. The Federal Deposit Insurance Corporation may increase or decrease the range of assessments uniformly, except that no adjustment can deviate more than two basis points from the base assessment rate without notice and comment rulemaking. The existing system represents a change, required by the Dodd-Frank Act, from the Federal Deposit Insurance Corporation's prior practice of basing the assessment on an institution's aggregate deposits.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The Federal Deposit Insurance Corporation was required to seek to achieve the 1.35% ratio by September 30, 2020. The Federal Deposit Insurance Corporation indicated that the 1.35% ratio was exceeded in November 2018. Insured institutions of less than \$10 billion of assets will receive credits for the portion of their assessments that contributed to the reserve ratio between 1.15% and 1.35%. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the Federal Deposit Insurance Corporation, and the Federal Deposit Insurance Corporation has exercised that discretion by establishing a long-range fund ratio of 2%.

The Federal Deposit Insurance Corporation has the authority to increase insurance assessments. A significant increase in insurance premiums would have an adverse effect on the operating expenses and results of operations of WaterStone Bank. We cannot predict what deposit insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation. We do not know of any practice, condition or violation that might lead to termination of deposit insurance.



## ***Capitalization***

***Wisconsin Law and Regulation.*** Wisconsin savings banks are required to maintain a minimum capital to assets ratio of 6% and must maintain total capital necessary to ensure the continuation of insurance of deposit accounts by the Federal Deposit Insurance Corporation. If the WDFI determines that the financial condition, history, management or earning prospects of a savings bank are not adequate, the WDFI may require a higher minimum capital level for the savings bank. If a Wisconsin savings bank's capital ratio falls below the required level, the WDFI may direct the savings bank to adhere to a specific written plan established by the WDFI to correct the savings bank's capital deficiency, as well as a number of other restrictions on the savings bank's operations, including a prohibition on the payment of dividends. At December 31, 2019, WaterStone Bank's capital to assets ratio, as calculated under Wisconsin law, was 17.15%.

***Federal Law and Regulation.*** Federal regulations require Federal Deposit Insurance Corporation 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 risk-based assets ratio of 6.0%, a total capital to risk-based assets of 8.0%, and a 4.0% Tier 1 capital to total assets leverage ratio.

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 ("AOCI"), up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Institutions that have not exercised the AOCI opt-out have AOCI incorporated into common equity Tier 1 capital (including unrealized gains and losses on available-for-sale securities). WaterStone Bank exercised its AOCI opt-out election. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations.

In determining the amount of risk-weighted assets for purposes of calculating risk-based capital ratios, all assets, including certain off-balance sheet assets (e.g., 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. For example, a risk weight of 0% is assigned to cash and U.S. government securities, a risk weight of 50% is generally assigned to prudently underwritten first lien one to four- family residential real estate loans, a risk weight of 100% is assigned to commercial and consumer loans, a risk weight of 150% is assigned to certain past due loans and a risk weight of between 0% to 600% is assigned to permissible equity interests, depending on certain specified factors.

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 was phased in beginning January 1, 2016 until fully implemented at 2.5% on January 1, 2019.

In assessing an institution's capital adequacy, the Federal Deposit Insurance Corporation takes into consideration, not only these numeric factors, but qualitative factors as well, including the bank's exposure to interest rate risk. The Federal Deposit Insurance Corporation has the authority to establish higher capital requirements for individual institutions where deemed necessary due to a determination that an institution's capital level is, or is likely to become, inadequate in light of particular circumstances.

Legislation enacted in May 2018 required the federal banking agencies, including the Federal Deposit Insurance Corporation, to establish an optional "community bank leverage ratio" of between 8% to 10% of average total consolidated assets for qualifying institutions with assets of less than \$10 billion of assets. Institutions with capital meeting the specified requirement and electing to follow the alternative framework would be deemed to comply with the applicable regulatory capital requirements, including the risk-based requirements. The federal regulators issued a final rule, effective January 1, 2020, that set the elective community bank leverage ratio at 9% tier 1 capital to average total consolidated assets.

## ***Safety and Soundness Standards***

Each federal banking agency, including the Federal Deposit Insurance Corporation, has adopted guidelines establishing general standards relating to internal controls, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits, and information security. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder.

## ***Prompt Corrective Regulatory Action***

Federal bank regulatory authorities are required to take "prompt corrective action" with respect to institutions that do not meet minimum capital requirements. For these purposes, the statute establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under the regulations, a bank is deemed to be (i) "well capitalized" if it has total risk-based capital of 10.0% or more, has a Tier 1 risk-based capital ratio of 8.0% or more, has a Tier 1 leverage capital ratio of 5.0% or more and a common equity Tier 1 ratio of 6.5% or more, and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 6.0% or more, a Tier 1 leveraged capital ratio of 4.0% or more and a common equity Tier 1 ratio of 4.5% or more, and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio that is less than 6.0%, a Tier 1 leverage capital ratio that is less than 4.0% or a common equity Tier 1 ratio of less than 4.5%; (iv) "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0% and a Tier 1 risk-based capital ratio that is less than 4.0% or a common equity Tier 1 ratio of less than 3.0%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

Federal law and regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an institution classified as less than well capitalized to comply with supervisory actions as if it were in the next lower category (except that the Federal Deposit Insurance Corporation may not reclassify a significantly undercapitalized institution as critically undercapitalized).

The Federal Deposit Insurance Corporation may order savings banks that have insufficient capital to take corrective actions. For example, a savings bank that is categorized as “undercapitalized” is subject to growth limitations and is required to submit a capital restoration plan, and a holding company that controls such a savings bank is required to guarantee that the savings bank complies with the restoration plan. A “significantly undercapitalized” savings bank may be subject to additional restrictions. Savings banks deemed by the Federal Deposit Insurance Corporation to be “critically undercapitalized” would be subject to the appointment of a receiver or conservator.

At December 31, 2019, WaterStone Bank was considered well-capitalized with a common equity Tier 1 ratio of 22.05%, Tier 1 leverage ratio of 17.11%, a Tier 1 risk-based ratio of 22.05% and a total risk based capital ratio of 22.85%.

The previously referenced final rule that establishes an elective community bank leverage ratio provides that a qualifying institution whose tier 1 capital equals or exceeds the specified community bank leverage ratio and opts into that framework will be considered well capitalized for prompt corrective action purposes.

Banking regulators addressed the regulatory capital treatment of credit loss allowance under Accounting Standard Update (ASU) No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" (CECL) methodology by allowing banking organizations an option to phase in the day-one regulatory capital effects. See Note 1 for the section "Recent Accounting Pronouncements" for additional information regarding the adoption of this standard.

### ***Dividends***

Under Wisconsin law and applicable regulations, a Wisconsin savings bank that meets its regulatory capital requirements may declare dividends on capital stock based upon net profits, provided that its paid-in surplus equals its capital stock. In addition, prior WDFI approval is required before dividends exceeding 50% of net profits for any calendar year may be declared and before a stock dividend may be declared out of retained earnings. Under WDFI regulations, a Wisconsin savings bank which has converted from mutual to stock form also is prohibited from paying a dividend on its capital stock if the payment causes the regulatory capital of the savings bank to fall below the amount required for its liquidation account.

The Federal Deposit Insurance Corporation has the authority to prohibit WaterStone Bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice in light of the financial condition of WaterStone Bank. Institutions may not pay dividends if they would be “undercapitalized” following payment of the dividend within the meaning of the prompt corrective action regulations.

Information with respect to regulation regarding dividends declared and paid by Waterstone Financial is disclosed under "Holding Company Dividends."

### ***Liquidity and Reserves***

*Wisconsin Law and Regulation.* Under WDFI regulations, all Wisconsin savings banks are required to maintain a certain amount of their assets as liquid assets, consisting of cash and certain types of investments. The exact amount of assets a savings bank is required to maintain as liquid assets is set by the WDFI, but generally ranges from 4% to 15% of the savings bank’s average daily balance of net withdrawable accounts plus short-term borrowings (the “Required Liquidity Ratio”). At December 31, 2019, WaterStone Bank’s Required Liquidity Ratio was 8.0%, and WaterStone Bank was in compliance with this requirement. In addition, 50% of the liquid assets maintained by a Wisconsin savings bank must consist of “primary liquid assets,” which are defined to include securities issued by the United States Government, United States Government agencies, or the state of Wisconsin or a subdivision thereof, and cash. At December 31, 2019, WaterStone Bank was in compliance with this requirement.

*Federal Law and Regulation.* Under federal law and regulations, WaterStone Bank is required to maintain sufficient liquidity to ensure safe and sound banking practices. Regulation D, promulgated by the Federal Reserve Board, imposes reserve requirements on all depository institutions, including WaterStone Bank, which maintain transaction accounts or non-personal time deposits. Checking accounts, NOW accounts, Super NOW checking accounts, and certain other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to Regulation D reserve requirements, as are any non-personal time deposits (including certain money market deposit accounts) at a savings institution. For 2019, a depository institution was required to maintain average daily reserves equal to 3% on the first \$124.2 million of transaction accounts, plus 10% of that portion of total transaction accounts in excess of \$124.2 million. The first \$16.3 million of otherwise reservable balances was exempt from the reserve requirements. These percentages and threshold limits are subject to annual adjustment by the Federal Reserve Board and increased to a threshold of \$127.5 million and an exemption of \$16.3 million for 2020. As of December 31, 2019, WaterStone Bank met its Regulation D reserve requirements.

### ***Transactions with Affiliates and Insiders***

***Wisconsin Law and Regulation.*** Under Wisconsin law, a savings bank may not make a loan to a person owning 10% or more of its stock, an affiliated person (including a director, officer, the spouse of either and a member of the immediate family of such person who is living in the same residence), agent, or attorney of the savings bank, either individually or as an agent or partner of another, except as under the rules of the WDFI and regulations of the Federal Deposit Insurance Corporation. In addition, unless the prior approval of the WDFI is obtained, a savings bank may not purchase, lease or acquire a site for an office building or an interest in real estate from an affiliated person, including a shareholder owning more than 10% of its capital stock, or from any firm, corporation, entity or family in which an affiliated person or 10% shareholder has a direct or indirect interest.

***Federal Law and Regulation.*** Sections 23A and 23B of the Federal Reserve Act govern transactions between an insured savings bank, such as WaterStone Bank, and any of its affiliates, including Waterstone Financial. The Federal Reserve Board has adopted Regulation W, which comprehensively implements and interprets Sections 23A and 23B, in part by codifying prior Federal Reserve Board interpretations under Sections 23A and 23B.

An affiliate of a savings bank is any company or entity that controls, is controlled by or is under common control with the savings bank. A subsidiary of a savings bank that is not also a depository institution or a “financial subsidiary” under federal law is not treated as an affiliate of the savings bank for the purposes of Sections 23A and 23B; however, the Federal Deposit Insurance Corporation has the discretion to treat subsidiaries of a savings bank as affiliates on a case-by-case basis. Sections 23A and 23B limit the extent to which a savings bank or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such savings bank’s capital stock and surplus, and limit all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The term “covered transaction” includes the making of loans, purchase of assets, issuance of guarantees and other similar types of transactions. Further, most loans and other extensions of credit by a savings bank to any of its affiliates must be secured by collateral in amounts ranging from 100% to 130% of the loan amounts, depending on the type of collateral. In addition, any affiliate transaction by a savings bank must be on terms that are substantially the same, or at least as favorable, to the savings bank as those that would be provided to a non-affiliate, and be consistent with safe and sound banking practices.

A savings bank’s loans to its executive officers, directors, any owner of more than 10% of its stock (each, an insider) and any of certain entities affiliated with any such person (an insider’s related interest) are subject to the conditions and limitations imposed by Section 22(h) of the Federal Reserve Act and the Federal Reserve Board’s Regulation O thereunder. Under these restrictions, the aggregate amount of the loans to any insider and the insider’s related interests may not exceed the loans-to-one-borrower limit applicable to national banks, (which is generally 15% of capital and surplus). Aggregate loans by a savings bank to its insiders and insiders’ related interests in the aggregate may not exceed the savings bank’s unimpaired capital and unimpaired surplus. With certain exceptions, loans to an executive officer, other than loans for the education of the officer’s children and certain loans secured by the officer’s primary residence, may not exceed the greater of \$25,000 or 2.5% of the savings bank’s unimpaired capital and unimpaired surplus, but in no event more than \$100,000. Regulation O also requires that any proposed loan to an insider or a related interest of that insider be approved in advance by a majority of the board of directors of the savings bank, with any interested director not participating in the voting, if such loan, when aggregated with any existing loans to that insider and the insider’s related interests, would exceed either \$500,000 or the greater of \$25,000 or 5% of the savings bank’s unimpaired capital and surplus. Generally, such loans must be made on substantially the same terms as, and follow credit underwriting procedures that are no less stringent than, those that are prevailing at the time for comparable transactions with other persons and must not present more than a normal risk of collectability.

An exception to the requirement is made for extensions of credit made pursuant to a benefit or compensation plan of a bank that is widely available to employees of the savings bank and that does not give any preference to insiders of the bank over other employees of the bank. Consistent with these requirements, the Bank offered employees special terms for home mortgage loans on their principal residences. Effective April 1, 2006, this program was discontinued for new loan originations. Under the terms of the discontinued program, the employee interest rate is based on the Bank’s cost of funds on December 31st of the immediately preceding year and is adjusted annually. At December 31, 2019, the rate of interest on an employee rate mortgage loan was 1.62%, compared to the weighted average rate of 4.54% on all single family mortgage loans. This rate increased to 1.73% effective March 1, 2020. Employee rate mortgage loans totaled \$1.0 million, or 0.3%, of our single family residential mortgage loan portfolio on December 31, 2019.

### ***Transactions between Bank Customers and Affiliates***

Wisconsin savings banks, such as WaterStone Bank, are subject to the prohibitions on certain tying arrangements. Subject to certain exceptions, a savings bank is prohibited from extending credit to or offering any other service to a customer, or fixing or varying the consideration for such extension of credit or service, on the condition that such customer obtain some additional service from the institution or certain of its affiliates or not obtain services of a competitor of the institution.

### ***Examinations and Assessments***

WaterStone Bank is required to file periodic reports with and is subject to periodic examinations by the WDFI and FDIC. WaterStone Bank is required to pay examination fees and annual assessments to fund its supervision. Federal regulations require annual on-site examinations for all depository institutions except certain well-capitalized and highly rated institutions with assets of less than \$3 billion which are examined every 18 months.

### ***Customer Privacy***

Under Wisconsin and federal law and regulations, savings banks, such as WaterStone Bank, are required to develop and maintain privacy policies relating to information on its customers, restrict access to and establish procedures to protect customer data. Applicable privacy regulations further restrict the sharing of non-public customer data with non-affiliated parties if the customer requests.

### ***Community Reinvestment Act***

Under the Community Reinvestment Act, WaterStone Bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The Community Reinvestment Act does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the Community Reinvestment Act. The Community Reinvestment Act requires the Federal Deposit Insurance Corporation, in connection with its examination of WaterStone Bank, to assess WaterStone Bank's record of meeting the credit needs of its community and to take that record into account in the Federal Deposit Insurance Corporation's evaluation of certain applications by WaterStone Bank. For example, the regulations specify that a bank's Community Reinvestment Act performance will be considered in its expansion (e.g., branching or merger) proposals and may be the basis for approving, denying or conditioning the approval of an application. As of the date of its most recent regulatory examination, WaterStone Bank was rated "satisfactory" with respect to its Community Reinvestment Act compliance.

### ***Federal Home Loan Bank System***

The Federal Home Loan Bank System, consisting of 11 Federal Home Loan Banks, is under the jurisdiction of the Federal Housing Finance Board. The designated duties of the Federal Housing Finance Board are to supervise the Federal Home Loan Banks; ensure that the Federal Home Loan Banks carry out their housing finance mission; ensure that the Federal Home Loan Banks remain adequately capitalized and able to raise funds in the capital markets; and ensure that the Federal Home Loan Banks operate in a safe and sound manner.

WaterStone Bank, as a member of the Federal Home Loan Bank of Chicago, is required to acquire and hold shares of capital stock in the Federal Home Loan Bank of Chicago in specified amounts. WaterStone Bank is in compliance with this requirement with an investment in Federal Home Loan Bank of Chicago stock of \$21.1 million at December 31, 2019.

Among other benefits, the Federal Home Loan Banks provide a central credit facility primarily for member institutions. It is funded primarily from proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes advances to members in accordance with policies and procedures established by the Federal Housing Finance Board and the board of directors of the Federal Home Loan Bank of Chicago. At December 31, 2019, WaterStone Bank had \$470.0 million in advances from the Federal Home Loan Bank of Chicago.

### ***USA PATRIOT Act***

The USA PATRIOT Act gives the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The USA PATRIOT Act also required the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if we engage in a merger or other acquisition, our controls designed to combat money laundering would be considered as part of the application process. We have established policies, procedures and systems designed to comply with these regulations.

### ***Regulation of Waterstone Mortgage Corporation***

Waterstone Mortgage Corporation is subject to numerous federal, state and local laws and regulations and may be subject to various judicial and administrative decisions imposing various requirements and restrictions on its business. These laws, regulations and judicial and administrative decisions to which Waterstone Mortgage Corporation is subject include those pertaining to: real estate settlement procedures; fair lending; fair credit reporting; truth in lending; compliance with net worth and financial statement delivery requirements; compliance with federal and state disclosure and licensing requirements; the establishment of maximum interest rates, finance charges and other charges; secured transactions; collection, foreclosure, repossession and claims-handling procedures; other trade practices and privacy regulations providing for the use and safeguarding of non-public personal financial information of borrowers; and guidance on non-traditional mortgage loans issued by the federal financial regulatory agencies. Waterstone Mortgage Corporation may also be required to comply with any additional requirements that its customers may be subject to by their regulatory authorities.

### ***Holding Company Regulation***

Waterstone Financial is a unitary savings and loan holding company subject to regulation and supervision by the Federal Reserve Board. The Federal Reserve Board has enforcement authority over Waterstone Financial and its non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a risk to WaterStone Bank. In addition, any company that owns or controls, directly or indirectly, more than 25% of the voting securities of a state savings bank is subject to regulation as a savings bank holding company by the WDFI. Waterstone Financial is subject to regulation as a savings bank holding company under Wisconsin law. However, the WDFI has not issued specific regulations governing savings bank holding companies.

As a savings and loan holding company, Waterstone Financial's activities are limited to those activities permissible by law for financial holding companies (if Waterstone Financial makes an election to be treated as a financial holding company and meets the other requirements to be a financial holding company) or multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, incidental to financial activities or complementary to a financial activity. Such activities include lending and other activities permitted for bank holding companies, insurance and underwriting equity securities. Multiple savings and loan holding companies are authorized to engage in activities specified by federal regulation.

Federal law prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring more than 5% of another savings institution or savings and loan holding company without prior written approval of the Federal Reserve Board, and from acquiring or retaining control of any depository institution not insured by the Federal Deposit Insurance Corporation. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider such things as the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on and the risk to the federal deposit insurance fund, the convenience and needs of the community and competitive factors. A savings and loan holding company may not acquire a savings institution in another state and hold the target institution as a separate subsidiary unless it is a supervisory acquisition under Section 13(k) of the Federal Deposit Insurance Act or the law of the state in which the target is located authorizes such acquisitions by out-of-state companies.

The Dodd-Frank Act required the Federal Reserve Board to impose upon bank and savings and loan holding companies consolidated regulatory capital requirements that are equally stringent as those applicable to the subsidiary depository institutions. However, legislation enacted in May 2018 required the Federal Reserve Board to raise the asset size threshold of its "small holding company" exception to the applicability of consolidated holding company capital requirements from \$1 billion to \$3 billion. That change became effective in 2018. Consequently, holding companies with less than \$3 billion of consolidated assets, such as Waterstone Financial, are generally not subject to the requirements unless otherwise advised by the Federal Reserve Board.

The Dodd-Frank Act extended the "source of strength" doctrine to savings and loan holding companies. The Federal Reserve Board promulgated regulations implementing the "source of strength" policy, which requires holding companies to act as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

The Federal Reserve Board has issued a policy statement regarding the payment of dividends and the repurchase of shares of common stock by bank holding companies and savings and loan 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 condition. Regulatory guidance provides for prior regulatory consultation with respect to capital distributions in certain circumstances such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund a proposed dividend or the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. The policy statement also states that a holding company should inform the Federal Reserve Board supervisory staff, to provide opportunity for supervisory review and possible objection, prior to redeeming or repurchasing common stock or perpetual preferred stock if the holding company is experiencing financial weaknesses or if the repurchase or redemption would result in a net reduction, as of the end of a quarter, in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption or repurchase occurred. These regulatory policies may affect the ability of Waterstone Financial to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

#### ***Holding Company Dividends***

Waterstone Financial will not be permitted to pay dividends on its common stock if its stockholders' equity would be reduced below the amount of the liquidation account established by Waterstone Financial in connection with the conversion. The source of dividends will depend on the net proceeds retained by Waterstone Financial and earnings thereon, and dividends from WaterStone Bank. In addition, Waterstone Financial will be subject to relevant state corporate law limitations and federal bank regulatory policy on the payment of dividends. Maryland law, which is the state of Waterstone Financial's incorporation, generally limits dividends if the corporation would not be able to pay its debts in the usual course of business after giving effect to the dividend or if the corporation's total assets would be less than the corporation's total liabilities plus the amount needed to satisfy the preferential rights upon dissolution of stockholders whose preferential rights on dissolution are superior to those receiving the distribution.

The dividend rate and continued payment of dividends will depend on a number of factors, including our capital requirements, our financial condition and results of operations, tax considerations, statutory and regulatory limitations, and general economic conditions.

#### ***Federal Securities Laws Regulation***

*Securities Exchange Act.* Waterstone Financial common stock is registered with the Securities and Exchange Commission. Waterstone Financial is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

Shares of common stock purchased by persons who are not affiliates of Waterstone Financial may be resold without registration. Shares purchased by an affiliate of Waterstone Financial are subject to the resale restrictions of Rule 144 under the Securities Act of 1933. If Waterstone Financial meets the current public information requirements of Rule 144 under the Securities Act of 1933, each affiliate of Waterstone Financial that complies with the other conditions of Rule 144, including those that require the affiliate's sale to be aggregated with those of other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three-month period, the greater of 1% of the outstanding shares of Waterstone Financial, or the average weekly volume of trading in the shares during the preceding four calendar weeks. In the future, Waterstone Financial may permit affiliates to have their shares registered for sale under the Securities Act of 1933.

*Sarbanes-Oxley Act of 2002.* The Sarbanes-Oxley Act of 2002 is intended to improve corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. We have policies, procedures and systems designed to comply with these regulations, and we review and document such policies, procedures and systems to ensure continued compliance with these regulations.

## ***Change in Control Regulations***

Under the Change in Bank Control Act, no person may acquire control of a savings and loan holding company such as Waterstone Financial unless the Federal Reserve Board 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 acquiror 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 savings and loan holding company's voting stock constitutes a rebuttable determination of control under the regulations under certain circumstances including where, as is the case with Waterstone Financial, the issuer has registered securities under Section 12 of the Securities Exchange Act of 1934.

In addition, federal regulations provide that no company may acquire control of a savings and loan holding company without the prior approval of the Federal Reserve Board. Any company that acquires such control becomes a "savings and loan holding company" subject to registration, examination and regulation by the Federal Reserve Board.

## **Federal and State Taxation**

### ***Federal Taxation***

*General.* Waterstone Financial and subsidiaries are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. Waterstone Financial and subsidiaries constitute an affiliated group of corporations and, therefore, are eligible to report their income on a consolidated basis. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Waterstone Financial or WaterStone Bank. The Company is no longer subject to federal tax examinations for years before 2016.

*Method of Accounting.* For federal income tax purposes, Waterstone Financial currently reports its income and expenses on the accrual method of accounting and uses a tax year ending December 31 for filing its federal income tax returns.

*Bad Debt Reserves.* Prior to the Small Business Protection Act of 1996 (the "1996 Act"), WaterStone Bank was permitted to establish a reserve for bad debts and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at our taxable income. As a result of the 1996 Act, WaterStone Bank was required to use the specific charge-off method in computing its bad debt deduction beginning with its 1996 federal tax return. Savings institutions were required to recapture any excess reserves over those established as of December 31, 1987 (base year reserve). At December 31, 2019, WaterStone Bank had no reserves subject to recapture in excess of its base year.

Waterstone Financial is required to use the specific charge-off method to account for tax bad debt deductions.

*Taxable Distributions and Recapture.* Prior to 1996, bad debt reserves created prior to 1988 were subject to recapture into taxable income if WaterStone Bank failed to meet certain thrift asset and definitional tests or made certain distributions. Tax law changes in 1996 eliminated thrift-related recapture rules. However, under current law, pre-1988 tax bad debt reserves remain subject to recapture if WaterStone Bank makes certain non-dividend distributions, repurchases any of its common stock, pays dividends in excess of earnings and profits, or fails to qualify as a "bank" for tax purposes. At December 31, 2019, our total federal pre-base year bad debt reserve was approximately \$16.7 million.

*Corporate Dividends-Received Deduction.* Waterstone Financial may exclude from its federal taxable income 100% of dividends received from WaterStone Bank as a wholly-owned subsidiary by filing consolidated tax returns. The corporate dividends-received deduction is 65% when the corporation receiving the dividend owns at least 20% of the stock of the distributing corporation. The dividends-received deduction is 50% when the corporation receiving the dividend owns less than 20% of the distributing corporation.

### ***State Taxation***

The Company is subject to primarily the Wisconsin corporate franchise (income) tax and taxation in a number of states due primarily to the operations of the mortgage banking segment. Under current law, the state of Wisconsin imposes a corporate franchise tax of 7.9% on the combined taxable incomes of the members of our consolidated income tax group.

The Company is no longer subject to state income tax examinations by certain state tax authorities for years before 2015.

As a Maryland business corporation, Waterstone Financial is required to file an annual report and pay franchise taxes to the state of Maryland.

## **Item 1A. Risk Factors**

An investment in our securities is subject to risks inherent in our business and the industry in which we operate. Before making an investment decision, you should carefully consider the risks and uncertainties described below and all other information included in this report. The risks described below may adversely affect our business, financial condition and operating results. In addition to these risks and the other risks and uncertainties described in Item 1, “Business-Forward Looking Statements” and Item 7, “Management's Discussion and Analysis of Financial Condition and Results of Operations,” there may be additional risks and uncertainties that are not currently known to us or that we currently deem to be immaterial that could materially and adversely affect our business, financial condition or operating results. The value or market price of our securities could decline due to any of these identified or other risks. Past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

### **We operate in a highly regulated environment and we are subject to supervision, examination and enforcement action by various bank regulatory agencies.**

We are subject to extensive supervision, regulation, and examination by the WDFI, the Federal Deposit Insurance Corporation and the Federal Reserve Board. As a result, we are limited in the manner in which we conduct our business, undertake new investments and activities, and obtain financing. This system of regulation is designed primarily for the protection of the Deposit Insurance Fund and our depositors, and not for the benefit of our stockholders. Under this system of regulation, the regulatory authorities have extensive discretion in connection with their supervisory, enforcement, rulemaking and examination activities and policies, including rules or policies that: establish minimum capital levels; restrict the timing and amount of dividend payments; govern the classification of assets; determine the adequacy of loan loss reserves for regulatory purposes; and establish the timing and amounts of assessments and fees.

Moreover, as part of their examination authority, the banking regulators assign numerical ratings to banks and savings institutions relating to capital, asset quality, management, liquidity, earnings and other factors. These ratings are inherently subjective and the receipt of a less than satisfactory rating in one or more categories may result in enforcement action by the banking regulators against a financial institution. A less than satisfactory rating may also prevent a financial institution, such as WaterStone Bank or its holding company, from obtaining necessary regulatory approvals to access the capital markets, paying dividends, acquiring other financial institutions or establishing new branches.

In addition, we must comply with significant anti-money laundering and anti-terrorism laws and regulations, Community Reinvestment Act laws and regulations, and fair lending laws and regulations. Government agencies have the authority to impose monetary penalties and other sanctions on institutions that fail to comply with these laws and regulations, which could significantly affect our business activities, including our ability to acquire other financial institutions or expand our branch network.

### **Changing interest rates may have a negative effect on our results of operations.**

Our earnings and cash flows are dependent on our net interest income and income from our mortgage banking operations. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in market interest rates could have an adverse effect on our financial condition and results of operations.

Decreases in interest rates often result in increased prepayments of loans and mortgage-related securities, as borrowers refinance their loans to reduce borrowings costs. Under these circumstances, we are subject to reinvestment risk to the extent we are unable to reinvest the cash received from such prepayments in loans or other investments that have interest rates that are comparable to the interest rates on existing loans and securities.

Increases in interest rates can also have an adverse impact on our results of operations. A portion of our loans have adjustable interest rates. While the higher payment amounts we would receive on these loans in a rising interest rate environment may increase our interest income, some borrowers may be unable to afford the higher payment amounts, which may result in a higher rate of loan delinquencies and defaults, as well as lower loan originations, as borrowers who may qualify for a loan based on certain mortgage repayments, may not be able to afford repayments based on higher interest rates for the same loan amounts. The marketability of the underlying collateral also may be adversely affected in a high interest rate environment.

Although we have implemented asset and liability management strategies designed to reduce the effects of changes in interest rates on our results of operations, any substantial, unexpected, prolonged change in market interest rate could have a material adverse effect on our financial condition and results of operations. Also, our interest rate models and assumptions likely may not fully predict or capture the impact of actual interest rate changes on our balance sheet.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Management of Market Risk.”

### **We rely heavily on certificates of deposit, which has increased our cost of funds and could continue to do so in the future.**

Our reliance on certificates of deposit to fund our operations has resulted in a higher cost of funds than would otherwise be the case if we had a higher percentage of demand deposits, savings deposits and money market accounts. In addition, if our certificates of deposit do not remain with us, we may be required to access other sources of funds, including loan sales, other types of deposits, including replacement certificates of deposit, securities sold under agreements to repurchase, advances from the Federal Home Loan Bank of Chicago and other borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on our certificates of deposit.

**We intend to increase our commercial business lending, and we intend to continue our commercial real estate and multi-family residential real estate lending, which may expose us to increased lending risks and have a negative effect on our results of operations.**

We continue to focus on originating commercial business, commercial real estate and multi-family residential real estate loans. These types of loans generally have a higher risk of loss compared to our one- to four-family residential real estate loans. Commercial business loans may expose us to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. In addition, commercial business and commercial real estate loans may also involve relatively large loan balances to individual borrowers or groups of borrowers. These loans also have greater credit risk than residential real estate loans as repayment is generally dependent upon the successful operation of the borrower's business. Also, the collateral underlying commercial business loans may fluctuate in value. Some of our commercial business loans are collateralized by equipment, inventory, accounts receivable or other business assets, and the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use. Multi-family residential real estate and commercial real estate loans involve increased risk because repayment is dependent on income being generated in amounts sufficient to cover property maintenance and debt service. In addition, if loans that are collateralized by real estate become troubled and the value of the real estate has been significantly impaired, then we may not be able to recover the full contractual amount of principal and interest that we anticipated at the time we originated the loan, which could cause us to increase our provision for loan losses and adversely affect our financial condition and results of operations.

**Consumers may decide to use alternative options to complete financial transactions.**

Technology is allowing parties to complete financial transactions through alternative methods that historically have involved banks. Consumers can now easily access historically banking needs through online banking accounts, brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete certain transactions without the assistance of banks.

The removal of banking with financial transactions could result in the loss of customer loans, customer deposits, and the related fee income generated from those loans and deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

**Secondary mortgage market conditions could have a material impact on our financial condition and results of operations.**

Our mortgage banking operations provide a significant portion of our non-interest income. In addition to being affected by interest rates, the secondary mortgage markets are also subject to investor demand for residential mortgage loans and increased investor yield requirements for these loans. These conditions may fluctuate or worsen in the future. In light of current conditions, there is greater risk in retaining mortgage loans pending their sale to investors. We believe our ability to retain fixed-rate residential mortgage loans is limited. As a result, a prolonged period of secondary market illiquidity may reduce our loan production volumes and could have a material adverse effect on our financial condition and results of operations.

**Changes in the programs offered by secondary market purchasers or our ability to qualify for their programs may reduce our mortgage banking revenues, which would negatively impact our non-interest income.**

We generate mortgage revenues primarily from gains on the sale of single-family mortgage loans pursuant to programs currently offered by Fannie Mae, Freddie Mac, Ginnie Mae and non-GSE investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. Any future changes in these programs, our eligibility to participate in such programs, the criteria for loans to be accepted or laws that significantly affect the activity of such entities could, in turn, materially adversely affect our results of operations.

**A protracted government shutdown may result in reduced loan originations and related gains on sale and could negatively affect our financial condition and results of operations.**

Our mortgage banking operations provide a significant portion of our non-interest income. During any protracted federal government shutdown, we may not be able to close certain loans and we may not be able to recognize non-interest income on the sale of loans. Some of the loans we originate are sold directly to government agencies, and some of these sales may be unable to be consummated during the shutdown. In addition, we believe that some borrowers may determine not to proceed with their home purchase and not close on their loans, which would result in a permanent loss of the related non-interest income. A federal government shutdown could also result in reduced income for government employees or employees of companies that engage in business with the federal government, which could result in greater loan delinquencies, increases in our nonperforming, criticized and classified assets and a decline in demand for our products and services.

**If we are required to repurchase mortgage loans that we have previously sold, it could negatively affect our earnings.**

One of our primary business operations is our mortgage banking, which involves originating residential mortgage loans for sale in the secondary market under agreements that contain representations and warranties related to, among other things, the origination and characteristics of the mortgage loans. We may be required to repurchase mortgage loans that we have sold in cases of borrower default or breaches of these representations and warranties. If we are required to repurchase mortgage loans or provide indemnification or other recourse, this could increase our costs and thereby affect our future earnings.

**Changes in economic conditions could adversely affect our earnings, as our borrowers' ability to repay loans and the value of the collateral securing our loans decline.**

Economic conditions have an impact, to some extent, on our overall performance. Conditions such as an economic recession, rising unemployment, changes in interest rates, money supply and other factors beyond our control may adversely affect our asset quality, deposit levels and loan demand and, therefore, our earnings. Because a majority of our loans are secured by real estate, decreases in real estate values could adversely affect the value of property used as collateral. Adverse changes in the economy may also have a negative effect on the ability of our borrowers to make timely repayments of their loans, which could have an adverse impact on our earnings. Consequently, declines in the economy in our market area could have a material adverse effect on our financial condition and results of operations.



**Legal and regulatory proceedings and related matters could adversely affect us or the financial services industry in general.**

We, and other participants in the financial services industry upon whom we rely to operate, have been and may in the future become involved in legal and regulatory proceedings. Most of the proceedings we consider to be in the normal course of our business or typical for the industry; however, it is inherently difficult to assess the outcome of these matters, and other participants in the financial services industry or we may not prevail in any proceeding or litigation.

Any litigation or regulatory proceeding could entail substantial costs and divert management's attention away from our operations, and any adverse determination could have a materially adverse effect on our business, brand or image, or our financial condition and results of our operations.

We are currently a defendant in multiple lawsuits alleging that Waterstone Mortgage Corporation violated certain provisions of the Fair Labor Standards Act. Although we intend to vigorously defend our interests in this matter and pursue all possible defenses against the claims, we may ultimately be required to pay significant damages and attorney fees, which would adversely affect our financial condition and results of operations. See Note 14 - Commitments, Off-Balance Sheet Arrangements, and Contingent Liabilities of the notes to consolidated financial statements for additional information.

**If our allowance for loan losses is not sufficient to cover actual loan losses, our results of operations would be negatively affected.**

In determining the amount of the allowance for loan losses, we analyze our loss and delinquency experience by loan categories and we consider the effect of existing economic conditions. In addition, we make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. If the results of our analyses are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, which would require additions to our allowance and would decrease our net income. Our emphasis on loan growth and on increasing our portfolio of commercial real estate loans, as well as any future credit deterioration, could require us to increase our allowance further in the future.

The Financial Accounting Standards Board has adopted a new accounting standard that will be effective for us for our first fiscal year after December 15, 2019. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which may require us to increase our allowance for loan losses, and to greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for loan losses. Any resulting increase in our allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on our results of operations and financial condition. See Item (v) "Recent Accounting Pronouncements," below under the heading "Accounting Pronouncements not yet adopted by the company". See Note 1 for additional information regarding the adoption of this standard.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities may have a material adverse effect on our results of operations and financial condition.

**Because most of our borrowers are located in the Milwaukee, Wisconsin metropolitan area, a prolonged downturn in the local economy, or a decline in local real estate values, could cause an increase in nonperforming loans or a decrease in loan demand, which would reduce our profits.**

Substantially all of our loans are secured by real estate located in our primary market area. Weakness in our local economy and our local real estate markets could adversely affect the ability of our borrowers to repay their loans and the value of the collateral securing our loans, which could adversely affect our results of operations. Real estate values are affected by various factors, including supply and demand, changes in general or regional economic conditions, interest rates, governmental rules or policies and natural disasters. Weakness in economic conditions also could result in reduced loan demand and a decline in loan originations. In particular, a significant decline in real estate values would likely lead to a decrease in new loan originations and increased delinquencies and defaults by our borrowers.

**Strong competition within our market areas may limit our growth and profitability.**

Competition in the banking and financial services industry is intense. In our market areas, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, money market funds, insurance companies, and brokerage firms operating locally and elsewhere. Some of our competitors have greater name recognition and market presence and offer certain services that we do not or cannot provide, all of which benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively than we do.

**We may not be able to attract and retain skilled people.**

Our success depends, in large part, on our ability to attract and retain skilled people. Competition for the best people in most activities engaged in by us can be intense, and we may not be able to hire sufficiently skilled people or to retain them. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our markets, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

**Loss of key employees may disrupt relationships with certain customers.**

Our business is primarily relationship-driven in that many of our key employees have extensive customer relationships. Loss of a key employee with such customer relationships may lead to the loss of business if the customers were to follow that employee to a competitor. While we believe our relationship with our key personnel is good, we cannot guarantee that all of our key personnel will remain with our organization. Loss of such key personnel, should they enter into an employment relationship with one of our competitors, could result in the loss of some of our customers.

**Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions.**

The USA PATRIOT and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury's Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions. During the last year, several banking institutions have received large fines for non-compliance with these laws and regulations. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, these policies and procedures may not be effective in preventing violations of these laws and regulations.

**Monetary policies and regulations of the Federal Reserve Board could adversely affect our business, financial condition and results of operations.**

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve Board. An important function of the Federal Reserve Board is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve Board to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate and changes in banks' reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

**We are subject to the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to material penalties.**

The Community Reinvestment Act ("CRA"), the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. A successful regulatory challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on mergers and acquisitions activity and restrictions on expansion. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

**Changes in our accounting policies or in accounting standards could materially affect how we report our financial condition and results of operations.**

Our accounting policies are essential to understanding our financial condition and results of operations. Some of these policies require the use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Some of our accounting policies are critical because they require management to make difficult, subjective, and complex judgments about matters that are inherently uncertain, and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. If such estimates or assumptions underlying our financial statements are incorrect, we may experience material losses.

From time to time, the Financial Accounting Standards Board and the Securities and Exchange Commission change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of our financial statements. These changes are beyond our control, can be hard to predict and could materially affect how we report our financial condition and results of operations. We could also be required to apply a new or revised standard retroactively, which may result in our restating our prior period financial statements.

**We may be required to transition from the use of LIBOR in the future.**

In 2017, the Chief Executive of the United Kingdom Financial Conduct Authority, which regulates LIBOR, announced that it intends to stop persuading or compelling banks to submit rates for the calibration of LIBOR to the administrator of LIBOR after 2021. The announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. It is impossible to predict whether and to what extent banks will continue to provide LIBOR submissions to the administrator of LIBOR or whether any additional reforms to LIBOR may be enacted in the United Kingdom or elsewhere. At this time, no consensus exists as to what rate or rates may become acceptable alternatives to LIBOR and it is impossible to predict the effect of any such alternatives on the value of LIBOR-based securities and variable rate loans, subordinated debentures, or other securities or financial arrangements, given LIBOR's role in determining market interest rates globally. Uncertainty as to the nature of alternative reference rates and as to potential changes or other reforms to LIBOR may adversely affect LIBOR rates and the value of LIBOR-based loans and securities in our portfolio, and may impact the availability and cost of hedging instruments and borrowings. Our adjustable-rate mortgage loans are generally tied to the LIBOR. If LIBOR rates are no longer available, and we are required to implement substitute indices for the calculation of interest rates under our loan agreements with our borrowers, we may incur expenses in effecting the transition, and may be subject to disputes or litigation with customers over the appropriateness or comparability to LIBOR of the substitute indices, which could have an adverse effect on our results of operations.

**The need to account for certain assets at estimated fair value may adversely affect our results of operations.**

We report certain assets, such as loans held for sale, at estimated fair value. Generally, for assets that are reported at fair value, we use quoted market prices or valuation models that utilize observable market inputs to estimate fair value. Because we carry these assets on our books at their estimated fair value, we may incur losses even if the asset in question presents minimal credit risk.

**Changes in the valuation of our securities portfolio could adversely affect our profits.**

Our securities portfolio may be impacted by fluctuations in fair value, potentially reducing accumulated other comprehensive income and/or earnings. Fluctuations in fair value may be caused by changes in market interest rates, lower market prices for securities and limited investor demand. Management evaluates securities for other-than-temporary impairment on a monthly basis, with more frequent evaluation for selected issues. In analyzing a debt issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, industry analysts' reports and, to a lesser extent given the relatively insignificant levels of depreciation in our debt portfolio, spread differentials between the effective rates on instruments in the portfolio compared to risk-free rates. In analyzing an equity issuer's financial condition, management considers industry analysts' reports, financial performance and projected target prices of investment analysts within a one-year time frame. If this evaluation shows impairment to the actual or projected cash flows associated with one or more securities, a potential loss to earnings may occur. Changes in interest rates can also have an adverse effect on our financial condition, as our available-for-sale securities are reported at their estimated fair value, and therefore are impacted by fluctuations in interest rates. We increase or decrease our stockholders' equity by the amount of change in the estimated fair value of the available-for-sale securities, net of taxes. The declines in fair value could result in other-than-temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

**Because the nature of the financial services business involves a high volume of transactions, we face significant operational risks.**

We operate in diverse markets and rely on the ability of our employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from our operations, including but not limited to, the risk of fraud by employees or persons outside our company, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and compliance requirements, and business continuation and disaster recovery. Insurance coverage may not be available for such losses, or where available, such losses may exceed insurance limits. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, we could suffer financial loss, face regulatory action, and suffer damage to our reputation.

**Risks associated with system failures, interruptions, or breaches of cybersecurity could negatively affect our earnings.**

Information technology systems are critical to our business. We use various technology systems to manage our customer relationships, general ledger, securities investments, deposits and loans. We have established policies and procedures to prevent or limit the effect of system failures, interruptions, and security breaches, but such events may still occur or may not be adequately addressed if they do occur. Although we take numerous protective measures and otherwise endeavor to protect and maintain the privacy and security of confidential data, these systems may be vulnerable to unauthorized access, computer viruses, other malicious code, cyber-attacks, cyber-theft and other events that could have a security impact. If one or more of such events were to occur, this potentially could jeopardize confidential and other information processed and stored in, and transmitted through, our systems or otherwise cause interruptions or malfunctions in our or our customers' operations.

In addition, we outsource a majority of our data processing to certain third-party providers. If these third-party providers encounter difficulties, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any system failures, interruption, or breach of security could damage our reputation and result in a loss of customers and business, subject us to additional regulatory scrutiny, or expose us to litigation and possible financial liability. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are not fully covered by our insurance. Any of these events could have a material adverse effect on our financial condition and results of operations.

**Our risk management framework may not be effective in mitigating risk and reducing the potential for significant losses.**

Our risk management framework is designed to minimize risk and loss to us. We seek to identify, measure, monitor, report and control our exposure to risk, including strategic, market, liquidity, compliance and operational risks. While we use a broad and diversified set of risk monitoring and mitigation techniques, these techniques are inherently limited because they cannot anticipate the existence or future development of currently unanticipated or unknown risks. Recent economic conditions and heightened legislative and regulatory scrutiny of the financial services industry, among other developments, have increased our level of risk. Accordingly, we could suffer losses as a result of our failure to properly anticipate and manage these risks.

**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. We have 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.

**New lines of business or new products and services may subject us to additional risks.**

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. In addition, we will continue to make investments in research, development, and marketing for new products and services. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services we may invest significant time and resources. Initial timetables for the development and introduction of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. Furthermore, if customers do not perceive our new offerings as providing significant value, they may fail to accept our new products and services. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, the burden on management and our information technology of introducing any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, financial condition and results of operations.

**Acquisitions may disrupt our business and dilute stockholder value.**

We regularly evaluate merger and acquisition opportunities with other financial institutions and financial services companies. As a result, negotiations may take place and future mergers or acquisitions involving cash, debt, or equity securities may occur at any time. We would seek acquisition partners that offer us either significant market presence or the potential to expand our market footprint and improve profitability through economies of scale or expanded services.

Acquiring other banks, businesses, or branches may have an adverse effect on our financial results and may involve various other risks commonly associated with acquisitions, including, among other things:

- difficulty in estimating the value of the target company;
- payment of a premium over book and market values that may dilute our tangible book value and earnings per share in the short and long term;
- potential exposure to unknown or contingent tax or other liabilities of the target company;
- exposure to potential asset quality problems of the target company;
- potential volatility in reported income associated with goodwill impairment losses;
- difficulty and expense of integrating the operations and personnel of the target company;
- inability to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits;
- potential disruption to our business;
- potential diversion of our management's time and attention;
- the possible loss of key employees and customers of the target company; and
- potential changes in banking or tax laws or regulations that may affect the target company.

**Various factors may make takeover attempts more difficult to achieve.**

Our articles of incorporation and bylaws, federal regulations, Maryland law, shares of restricted stock and stock options that we have granted or may grant to employees and directors and stock ownership by our management and directors, and various other factors may make it more difficult for companies or persons to acquire control of Waterstone Financial without the consent of our board of directors. A shareholder may want a takeover attempt to succeed because, for example, a potential acquiror could offer a premium over the then prevailing price of our common stock.

**Our funding sources may prove insufficient to replace deposits at maturity and support our future growth.**

We must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. As we continue to grow, we are likely to become more dependent on these sources, which may include Federal Home Loan Bank advances, proceeds from the sale of loans, federal funds purchased and brokered certificates of deposit. Adverse operating results or changes in industry conditions could lead to difficulty or an inability to access these additional funding sources. Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. If we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our operating margins and profitability would be adversely affected.

**We are subject to environmental liability risk associated with lending activities.**

A significant portion of our loan portfolio is secured by real estate, and we could become subject to environmental liabilities with respect to one or more of these properties. During the ordinary course of business, we may foreclose on and take title to properties securing defaulted loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous conditions or toxic substances are found on these properties, we may be liable for remediation costs, as well as for personal injury and property damage, civil fines and criminal penalties regardless of when the hazardous conditions or toxic substances first affected any particular property. Environmental laws may require us to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on us.

**Item 1B. Unresolved Staff Comments**

None

**Item 2. Properties**

We operate from our corporate center, our 13 full-service banking offices, our drive-through office and 13 automated teller machines, located in Milwaukee, Washington and Waukesha Counties, Wisconsin. In addition, we operate a loan production office in Minneapolis, Minnesota. The net book value of our premises, land, equipment and leasehold improvements was \$25.0 million at December 31, 2019. The following table sets forth information with respect to our corporate center and our full-service banking offices as of December 31, 2019.

Corporate Center 11200 West Plank Court Wauwatosa, Wisconsin 53226	Wauwatosa 7500 West State Street Wauwatosa, Wisconsin 53213	Brookfield (1) 17495 W Capitol Dr. Brookfield, Wisconsin 53045
Franklin/Hales Corners 6555 South 108th Street Franklin, Wisconsin 53132	Germantown/Menomonee Falls W188N9820 Appleton Avenue Germantown, Wisconsin 53022	Oak Creek 6560 South 27th Street Oak Creek, Wisconsin 53154
Oconomowoc/Lake Country (1) 1233 Corporate Center Drive Oconomowoc, Wisconsin 53066	Pewaukee 1230 George Towne Drive Pewaukee, Wisconsin 53072	Waukesha/Brookfield 21505 East Moreland Blvd. Waukesha, Wisconsin 53186
West Allis/Greenfield Avenue 10101 West Greenfield Avenue West Allis, Wisconsin 53214	Fox Point/North Shore 8607 North Port Washington Road Fox Point, Wisconsin 53217	Greenfield/Loomis Road 5000 West Loomis Road Greenfield, Wisconsin 53220
West Allis/National Avenue 10296 West National Avenue West Allis, Wisconsin 53227	Oak Creek/Howell Avenue 8780 South Howell Avenue Oak Creek, Wisconsin 53154	Commercial Real Estate Loan Production Office (1) 333 Washington Avenue North Suite 304 Minneapolis, Minnesota 55401

(1) Leased property

In addition to our banking offices, as of December 31, 2019, Waterstone Mortgage Corporation had 10 offices in each of Wisconsin and Florida, eight offices in New Mexico, three offices in each of Delaware, Illinois, Minnesota, and Virginia, two offices in each of Arizona, Colorado, Maryland, Missouri, Ohio, Oklahoma, Oregon, and Virginia, and one office in each of Arkansas, California, Georgia, Idaho, Iowa, Michigan, New Hampshire, North Carolina and Pennsylvania.

**Item 3. Legal Proceedings**

See Note 14 - Commitments, Off-Balance Sheet Arrangements, and Contingent Liabilities of the notes to consolidated financial statements for additional information.

**Item 4. Mine Safety Disclosures**

Not applicable.

Part II

**Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchase of Equity Securities**

Our shares of common stock are traded on the NASDAQ Global Select Market® under the symbol WSBF. The approximate number of shareholders of record of Waterstone common stock as of February 28, 2020 was 1,400. On that same date there were 26,889,750 shares of common stock issued and outstanding.

Following are the Company's monthly common stock repurchases during the fourth quarter of 2019.

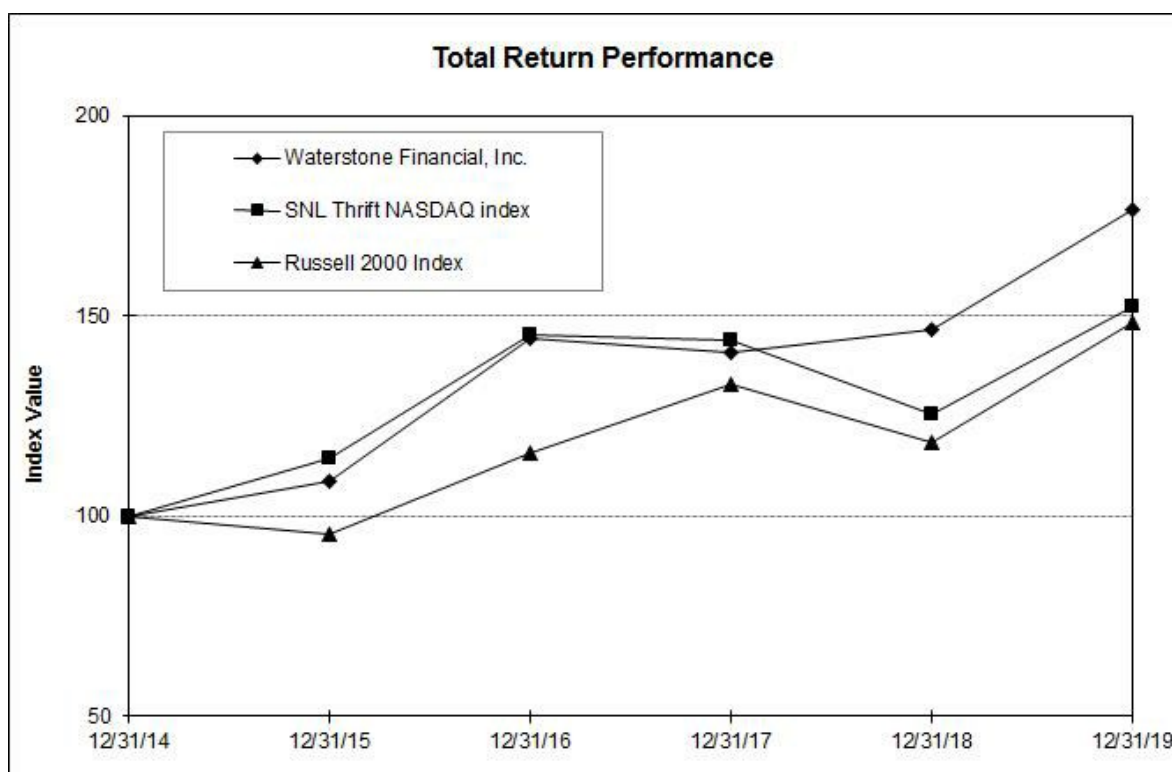
Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under the Plan <sup>(a)</sup>
October 1, 2019 - October 31, 2019	2,350	\$ 16.93	2,350	1,348,450
November 1, 2019 - November 30, 2019	-	-	-	1,348,450
December 1, 2019 - December 31, 2019	-	-	-	1,348,450
<b>Total</b>	<b>2,350</b>	<b>\$ 16.93</b>	<b>2,350</b>	<b>1,348,450</b>

(a) On May 30, 2019, the Board of Directors announced the completion of the then-existing stock repurchase plan and authorized the repurchase of 2,000,000 shares of common stock pursuant to a new share repurchase plan. This plan has no expiration date.

**PERFORMANCE GRAPH**

Set forth below is a line graph comparing the cumulative total shareholder return on Waterstone Financial common stock, based on the market price of the common stock and assuming reinvestment of cash dividends, with the cumulative total return of companies on the SNL Thrift NASDAQ Index and the Russell 2000. The graph assumes \$100 was invested on December 31, 2014, in Waterstone Financial, Inc. common stock and each of those indices.

***Waterstone Financial, Inc.***



Index	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19
Waterstone Financial, Inc.	100.00	108.87	144.52	141.03	146.68	176.63
SNL Thrift NASDAQ index	100.00	114.27	145.28	143.89	125.58	152.22
Russell 2000	100.00	95.59	115.95	132.94	118.30	148.49

**Item 6. Selected Financial Data**

The summary financial information presented below is derived in part from the Company's audited financial statements, although the table itself is not audited. The following data should be read together with the Company's consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" later in this report.

	<b>At or for the Year Ended December 31,</b>				
	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
	(In Thousands, except per share amounts)				
<b>Selected Financial Condition Data:</b>					
Total assets	\$ 1,996,347	\$ 1,915,381	\$ 1,806,401	\$ 1,790,619	\$ 1,762,729
Cash and cash equivalents	74,300	86,101	48,607	47,217	100,471
Securities available for sale	178,476	185,720	199,707	226,795	269,658
Loans held for sale	220,123	141,616	149,896	225,248	166,516
Loans receivable	1,388,031	1,379,148	1,291,814	1,177,884	1,114,934
Allowance for loan losses	12,387	13,249	14,077	16,029	16,185
Loans receivable, net	1,375,644	1,365,899	1,277,737	1,161,855	1,098,749
Real estate owned, net	748	2,152	4,558	6,118	9,190
Deposits	1,067,776	1,038,495	967,380	949,411	893,361
Borrowings	483,562	435,046	386,285	387,155	441,203
Total shareholders' equity	393,686	399,679	412,104	410,690	391,930
<b>Selected Operating Data:</b>					
Interest income	\$ 79,741	\$ 73,700	\$ 67,095	\$ 63,736	\$ 61,963
Interest expense	27,544	19,523	16,362	20,292	23,119
Net interest income	52,197	54,177	50,733	43,444	38,844
Provision for loan losses	(900)	(1,060)	(1,166)	380	1,965
Net interest income after provision for loan losses	53,097	55,237	51,899	43,064	36,879
Noninterest income	130,750	118,199	124,413	126,365	104,474
Noninterest expense	136,273	133,156	131,879	127,435	115,534
Income before income taxes	47,574	40,280	44,433	41,994	25,819
Provision for income taxes	11,671	9,526	18,469	16,462	9,249
Net income	\$ 35,903	\$ 30,754	\$ 25,964	\$ 25,532	\$ 16,570
<b>Per common share:</b>					
Income per share - basic	\$ 1.38	\$ 1.12	\$ 0.95	\$ 0.94	\$ 0.57
Income per share - diluted	\$ 1.37	\$ 1.11	\$ 0.93	\$ 0.93	\$ 0.56
Book value	\$ 14.50	\$ 14.04	\$ 13.97	\$ 13.95	\$ 13.33
Dividends declared	\$ 0.98	\$ 0.98	\$ 0.98	\$ 0.33	\$ 0.20

## At or for the Year Ended December 31,

	2019	2018	2017	2016	2015
<b>Selected Financial Ratios and Other Data:</b>					
<b>Performance Ratios:</b>					
Return on average assets	1.82 %	1.64 %	1.43 %	1.45%	0.94%
Return on average equity	9.14	7.60	6.32	6.33	3.99
Interest rate spread <sup>(1)</sup>	2.44	2.75	2.69	2.27	1.91
Net interest margin <sup>(2)</sup>	2.83	3.09	3.00	2.64	2.36
Noninterest expense to average assets	6.91	7.12	7.29	7.24	6.58
Efficiency ratio <sup>(3)</sup>	74.49	77.25	75.30	75.05	80.61
Average interest-earning assets to average interest-bearing liabilities	126.40	130.14	131.86	130.56	131.54
Dividend payout ratio <sup>(4)</sup>	71.01	87.50	103.16	27.66	35.20
<b>Capital Ratios:</b>					
<b>Waterstone Financial, Inc.:</b>					
Equity to total assets at end of period	19.72 %	20.87 %	22.81 %	22.94 %	22.23 %
Average equity to average assets	19.91	21.63	22.70	22.90	23.62
Total capital to risk-weighted assets	26.17	28.22	30.75	32.23	33.41
Tier 1 capital to risk-weighted assets	25.37	27.32	29.74	31.02	32.16
Common equity tier 1 capital to risk-weighted assets	25.37	27.32	29.74	31.02	32.16
Tier 1 capital to average assets	19.69	21.06	22.43	23.20	22.20
<b>WaterStone Bank:</b>					
Total capital to risk-weighted assets	22.85	26.95	28.93	29.50	30.92
Tier I capital to risk-weighted assets	22.05	26.05	27.92	28.29	29.67
Common equity tier 1 capital to risk-weighted assets	22.05	26.05	27.92	28.29	29.67
Tier I capital to average assets	17.11	20.08	21.10	21.17	20.45
<b>Asset Quality Ratios:</b>					
Allowance for loan losses as a percent of total loans	0.89 %	0.96 %	1.09 %	1.36 %	1.45 %
Allowance for loan losses as a percent of non-performing loans	176.33	202.12	231.99	162.62	91.94
Net (recoveries) charge-offs to average outstanding loans during the period	0.00	(0.02)	0.06	0.05	0.37
Non-performing loans as a percent of total loans	0.51	0.48	0.47	0.84	1.58
Non-performing assets as a percent of total assets	0.39	0.45	0.59	0.89	1.52
<b>Other Data:</b>					
Number of full-service banking offices	13	11	11	11	11
Number of full-time equivalent employees	824	888	927	895	770

(1) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.

(2) Represents net interest income as a percent of average interest-earning assets.

(3) Represents noninterest expense divided by the sum of net interest income and noninterest income.

(4) Represents dividends paid per share divided by basic earnings per share.



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

### **Overview**

The following discussion and analysis is presented to assist the reader in understanding and evaluating of the Company's financial condition and results of operations. It is intended to complement the consolidated financial statements, footnotes, and supplemental financial data appearing elsewhere in this Annual Report on Form 10-K and should be read in conjunction therewith. The detailed discussion in the sections below focuses on the results of operations for the years ended December 31, 2019, compared to the year ended December 2018, and the financial condition as of December 31, 2019 compared to the financial condition as of December 31, 2018.

As described in the notes to consolidated financial statements, we have two reportable segments: community banking and mortgage banking. The community banking segment provides consumer and business banking products and services to customers. Consumer products include loan products, deposit products, and personal investment services. Business banking products include loans for working capital, inventory and general corporate use, commercial real estate construction loans, and deposit accounts. The mortgage banking segment, which is conducted through Waterstone Mortgage Corporation, consists of originating residential mortgage loans primarily for sale in the secondary market.

Our community banking segment generates the significant majority of our consolidated net interest income and requires the significant majority of our provision for loan losses. Our mortgage banking segment generates the significant majority of our noninterest income and a majority of our noninterest expenses. We have provided below a discussion of the material results of operations for each segment on a separate basis for the year ended December 31, 2019, compared the year ended December 31, 2018, which focuses on noninterest income and noninterest expenses. We have also provided a discussion of the consolidated operations of Waterstone Financial, which includes the consolidated operations of WaterStone Bank and Waterstone Mortgage Corporation, for the same periods.

For a discussion of our results of operations for the year ended December 31, 2018 compared to the year ended December 31, 2017, see "Part II, Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations" Discussion of Results of Operations included in our 2018 Form 10-K, filed with the SEC on March 6, 2019.

### **Significant Items**

Earnings comparisons among the three years ended December 31, 2019, 2018, and 2017 were impacted by the Significant Items summarized below.

There were no Significant Items during the year ended December 31, 2019 or 2018.

As a result of The Tax Cuts and Jobs Act, the Company revalued its net deferred tax asset to reflect the reduction in its federal corporate income tax rate from 35% to 21%. This revaluation resulted in a one-time income tax expense of approximately \$2.7 million for the year ended December 31, 2017.

### **Critical Accounting Policies**

Critical accounting policies are those that involve significant judgments and assumptions by management and that have, or could have, a material impact on our income or the carrying value of our assets.

**Allowance for Loan Losses.** WaterStone Bank establishes valuation allowances on loans deemed to be impaired. A loan is considered impaired when, based on current information and events, it is probable that WaterStone Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. A valuation allowance is established for an amount equal to the impairment when the carrying amount of the loan exceeds the present value of the expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral (specific component). WaterStone Bank recognizes the change in present value of expected future cash flows on impaired loans attributable to the passage of time as bad debt expense. On an ongoing basis, at least quarterly for financial reporting purposes, the fair value of collateral dependent impaired loans and real estate owned is determined or reaffirmed by the following procedures:

- Obtaining updated real estate appraisals or performing updated discounted cash flow analysis;
- Confirming that the physical condition of the real estate has not significantly changed since the last valuation date;
- Comparing the estimated current book value to that of updated sales values experienced on similar real estate owned;
- Comparing the estimated current book value to that of updated values seen on more current appraisals of similar properties; and
- Comparing the estimated current book value to that of updated listed sales prices on our real estate owned and that of similar properties (not owned by the Company).

WaterStone Bank also establishes valuation allowances based on an evaluation of the various risk components that are inherent in the credit portfolio (general component). The risk components that are evaluated include past loan loss experience; the level of non-performing and classified assets; current economic conditions; volume, growth, and composition of the loan portfolio; adverse situations that may affect the borrower's ability to repay; the estimated value of any underlying collateral; regulatory guidance; and other relevant factors. The allowance is increased by provisions charged to earnings and recoveries of previously charged-off loans and reduced by charge-offs. Charge-offs approximate the amount by which the outstanding principal balance exceeds the estimated net realizable value of the underlying collateral. The appropriateness of the allowance for loan losses is reviewed and approved quarterly by the WaterStone Bank Board of Directors. The allowance reflects management's best estimate of the amount needed to provide for the probable loss on impaired loans and other inherent losses in the loan portfolio, and is based on a risk model developed and implemented by management and approved by the WaterStone Bank Board of Directors.

Actual results could differ from this estimate, and future additions to the allowance may be necessary based on unforeseen changes in loan quality and economic conditions. More specifically, if our future charge-off experience increases substantially from our past experience, or if the value of underlying loan collateral, in our case mostly real estate, declines in value by a substantial amount, or if unemployment in our primary market area increases significantly, our allowance for loan losses may be inadequate and we will incur higher provisions for loan losses and lower net income in the future.

In addition, state and federal regulators periodically review the WaterStone Bank allowance for loan losses. Such regulators have the authority to require WaterStone Bank to recognize additions to the allowance at the time of their examination.

**Income Taxes.** The Company and its subsidiaries file consolidated federal, combined state income tax, and separate state income tax returns. The provision for income taxes is based upon income in the consolidated financial statements, rather than amounts reported on the income tax return. 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 as well as for net operating loss carry forwards. 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 effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is “more likely than not” that a deferred tax asset will not be realized. The determination of the realizability of deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, the forecasts of future income, applicable tax planning strategies, and assessments of current and future economic and business conditions. Examples of positive evidence may include the existence of taxes paid in available carry-back years as well as the probability that taxable income will be generated in future periods. Examples of negative evidence may include cumulative losses in a current year and prior two years and general business and economic trends.

Positions taken in the Company's tax returns are subject to challenge by the taxing authorities upon examination. The benefit of uncertain tax positions are initially recognized in the financial statements only when it is more likely than not that the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. Interest and penalties on income tax uncertainties are classified within income tax expense in the income statement.

**Fair Value Measurements.** The Company determines the fair value of its assets and liabilities in accordance with ASC 820. ASC 820 establishes a standard framework for measuring and disclosing fair value under generally accepted accounting principles. A number of valuation techniques are used to determine the fair value of assets and liabilities in the Company's financial statements. The valuation techniques include quoted market prices for investment securities, appraisals of real estate from independent licensed appraisers and other valuation techniques. Fair value measurements for assets and liabilities where limited or no observable market data exists are based primarily upon estimates, and are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the valuation results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there are inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values. Significant changes in the aggregate fair value of assets and liabilities required to be measured at fair value or for impairment are recognized in the income statement under the framework established by generally accepted accounting principles.

**Recent Accounting Pronouncements.** Refer to Note 1 of our consolidated financial statements for a description of recent accounting pronouncements including the respective dates of adoption and effects on results of operations and financial condition.

#### **Comparison of Consolidated Waterstone Financial, Inc. Financial Condition at December 31, 2019 and at December 31, 2018**

**Total Assets.** Total assets increased by \$81.0 million, or 4.2%, to \$2.00 billion at December 31, 2019 from \$1.92 billion at December 31, 2018. The increase in total assets primarily reflects an increase in loans held for sale, loans receivable, and right-of-use assets due to the adoption of the new lease accounting standard; partially offset by decreases in cash and cash equivalents and securities available for sale. The total assets increase reflects liability increases in deposits, additional short-term and long-term debt, and lease liabilities due to the adoption of the new lease accounting standard.

**Cash and Cash Equivalents.** Cash and cash equivalents decreased \$11.8 million to \$74.3 million at December 31, 2019 from \$86.1 million at December 31, 2018. The decrease in cash and cash equivalents primarily reflects the use of cash to fund loans held for sale, fund loans held for investment, pay dividends, and repurchase shares since December 31, 2018. Offsetting the decreases, cash and cash equivalents increased due to additional deposits and long-term FHLB borrowings along with a decrease in securities available for sale.

**Securities Available for Sale.** Securities available for sale decreased by \$7.2 million to \$178.5 million at December 31, 2019 from \$185.7 million at December 31, 2018. The decrease was due to paydowns in mortgage related securities and maturities of debt securities exceeding security purchases during the year.

**Loans Held for Sale.** Loans held for sale increased \$78.5 million, or 55.4%, to \$220.1 million at December 31, 2019 from \$141.6 million at December 31, 2018. The increase was due primarily to the production increase of refinance products, which was driven by the reduction in mortgage rates compared to the end of last year.

**Loans Receivable.** Loans receivable held for investment increased \$8.9 million, or 0.6%, to \$1.39 billion at December 31, 2019. The increase in total loans receivable was primarily attributable to increases in the construction and land, commercial real estate, and consumer loan categories. Offsetting those increases, the one- to four-family, multi-family, home equity, and commercial categories decreased.

**Allowance for Loan Losses.** The allowance for loan losses decreased \$862,000 to \$12.4 million at December 31, 2019 from \$13.2 million at December 31, 2018. The decrease resulted from a negative provision due to the improvement of key loan quality metrics decreasing the required allowance related to the loans collectively reviewed. The overall decrease was primarily related to the one- to four-family, multi-family, home equity, and commercial categories offset slightly by an increase to the construction and land and commercial real estate categories. See Note 3 for further discussion on the allowance for loan losses.

**Federal Home Loan Bank Stock.** Total Federal Home Loan Bank stock increased \$1.8 million to \$21.1 million at December 31, 2019. The increase reflects the ownership requirements in conjunction with the additional FHLB borrowings.

**Cash Surrender Value of Life Insurance.** Total cash surrender value of life insurance increased \$2.1 million, to \$69.7 million at December 31, 2019. The increase related to continued earnings and annual premiums paid.

**Real Estate Owned.** Total real estate owned decreased by \$1.4 million, or 65.2%, to \$748,000 at December 31, 2019, compared to \$2.2 million at December 31, 2018. During the year ended December 31, 2019, \$1.1 million was transferred from loans to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled \$2.4 million. There were no write-downs during the year ended December 31, 2019.

**Prepaid Expenses and Other Assets.** Total prepaid expenses and other assets increased \$8.7 million to \$31.2 million at December 31, 2019. The increase was primarily due to recording the right-of-use asset for operating leases, as a result of adopting the new lease accounting standard, along with an increase in funding receivables, for loans sold, from investors.

**Deposits.** Deposits increased by \$29.3 million to \$1.07 billion at December 31, 2019, from \$1.04 billion at December 31, 2018. The increase was driven by an increase of \$34.4 million in money market and savings deposits and \$3.9 million in time deposits offset by a decrease of \$9.0 million in demand deposits.

**Borrowings.** Total borrowings increased \$48.5 million to \$483.6 million at December 31, 2019, from \$435.0 million at December 31, 2018. The community banking segment borrowed a total of \$40.0 million additional long term borrowings to fund loan growth. External short term borrowings at the mortgage banking segment increased a total of \$8.5 million at December 31, 2019 from December 31, 2018 to fund loans held for sale.

**Other Liabilities.** Other liabilities increased \$9.3 million to \$47.1 million at December 31, 2019 compared to December 31, 2018. Other liabilities primarily increased due to operating lease liabilities being added to the statements of financial condition as a result of adopting the new lease accounting standard.

**Shareholders' Equity.** Shareholders' equity decreased by \$6.0 million, or 1.5%, to \$393.7 million at December 31, 2019 from \$399.7 million at December 31, 2018. Shareholders' equity decreased primarily due to the declaration of regular dividends and a special dividend and the repurchase of stock. Partially offsetting the decreases were increases from net income, stock options exercised, the increase in the fair value of the securities portfolio, and unearned ESOP shares as they continue to vest.

### **Comparison of Community Banking Segment Operations for the Years Ended December 31, 2019 and 2018**

Net income from our community banking segment for the year ended December 31, 2019 totaled \$24.6 million compared to \$24.9 million for the year ended December 31, 2018. Net interest income decreased \$927,000 to \$54.0 million for the year ended December 31, 2019 compared to \$54.9 million for the year ended December 31, 2018. Net interest income decreased due to an increase in interest expense as deposits and borrowings repriced at higher rates. Partially offsetting the increase in interest expense, interest income increased primarily due to increases in average loan balances and loan rates.

Provision for loan losses was a negative provision of \$1.1 million for the year ended December 31, 2019 compared to a negative provision of \$1.2 million for the year ended December 31, 2018.

Noninterest income increased \$721,000 for the year ended December 31, 2019 primarily due to increases in loan and deposit fees and cash surrender value of life insurance offset by a decrease in other income. The loan fees increased primarily due to increased prepayment penalties and loan fees associated with interest rate swaps related to current year originations. Cash surrender value of life insurance increased as the earnings rate increased slightly. Other income decreased primarily due to a decrease in rental income.

Compensation, payroll taxes, and other employee benefits expense decreased \$190,000 due primarily to decreases in health insurance and lower stock based compensation expenses offset primarily by increases in salaries expense and variable compensation. Occupancy, office furniture, and equipment increased due primarily to increased depreciation expense, snow removal, maintenance and repair expense, and computer supplies. Advertising expense increased in order to promote our deposit products. Data processing expenses increased due primarily to increased investments in technology. Professional fees decreased as consulting activity related to retail staff training decreased from 2018. Real estate owned expense decreased as there was a decrease in writedowns and decrease in management expense offset by a decrease in gain on sale of real estate owned. Other noninterest expense decreased primarily from the FDIC assessing credits for insurance.

Income tax expense increased \$23,000 to \$7.3 million for the year ended December 31, 2019. The increase was primarily due to a lower permanent deductions from tax-free municipal bonds. Additionally, the Company recognized a lower benefit related to stock awards exercised for the year ended December 31, 2019. Offsetting the increases, pre-tax income decreased \$274,000.

## Comparison of Mortgage Banking Segment Operations for the Years Ended December 31, 2019 and 2018

Net income from our mortgage banking segment increased \$5.4 million to \$11.2 million for the year ended December 31, 2019 compared to \$5.8 million for the year ended December 31, 2018. We originated \$2.92 billion in mortgage loans held for sale during the year ended December 31, 2019, which was an increase of \$324.5 million, or 12.5%, from the \$2.60 billion originated during the year ended December 31, 2018. The increase in loan production volume was driven by a 122.9% volume increase in refinance products and 1.0% volume increase in mortgage purchase products. Total mortgage banking income increased \$11.5 million, or 9.9%, to \$126.9 million during the year ended December 31, 2019 compared to \$115.4 million during the year ended December 31, 2018. Gross margin on loans originated and sold decreased approximately 1.9% for the year ended December 31, 2019. Gross margin on those loans originated and sold is the ratio of mortgage banking income (excluding the change in interest rate lock fair value) divided by total loan originations. The gross margin on those loans originated and sold compression reflects a higher mix of refinance products which generally yield a lower margin, and industry dynamics, as price-based competition has escalated to maintain market share. We sell loans on both a servicing-released and a servicing retained basis. Waterstone Mortgage Corporation has contracted with a third party to service the loans for which we retain servicing.

Our overall margin can be affected by the mix of both loan type (conventional loans versus governmental) and loan purpose (purchase versus refinance). Conventional loans include loans that conform to Fannie Mae and Freddie Mac standards, whereas governmental loans are those loans guaranteed by the federal government, such as a Federal Housing Authority or U.S. Department of Agriculture loan. Loans originated for the purchase of a residential property, which generally yield a higher margin than loans originated for refinancing existing loans, comprised 81.4% of total originations during the year ended December 31, 2019, compared to 90.6% of total originations during the year ended December 31, 2018. The mix of loan type trended towards more governmental loans and less conventional loans comprising 30.5% and 69.5% of all loan originations, respectively, during the year ended December 31, 2019, compared to 30.3% and 69.7% of all loan originations, respectively, during the year ended December 31, 2018.

There were no sales of mortgage servicing rights during the year ended December 31, 2019. During the year ended December 31, 2018, mortgage servicing rights related to \$148.7 million in loans receivable with a book value of \$1.0 million were sold at a gain of \$417,000.

Total compensation, payroll taxes and other employee benefits increased \$4.2 million, or 5.3%, to \$84.2 million for the year ended December 31, 2019 compared to \$80.0 million for the year ended December 31, 2018. The increase primarily related to increased commission expense, branch manager pay, and health insurance expense. Offsetting those increases, salary decreased as we closed underperforming branches over the past year. Occupancy, office furniture, and equipment expense decreased due to lower rent expense with the closing of underperforming branches. Advertising, communications, lower processing expenses, and other noninterest expenses decreased. Other noninterest expense decreased primarily due to a lower provision for branch losses. Data processing, real estate owned expense, and professional fees increased due primarily to new contracts, managing one real estate owned property, and ongoing litigation expenses.

Waterstone Mortgage Corporation originates loans in various states. The states where we originate greater than 10% of total activity are Florida and New Mexico.

## Comparison of Consolidated Waterstone Financial, Inc. Results of Operations for the Years Ended December 31, 2019 and 2018

	Years Ended December 31,	
	2019	2018
	(Dollars in Thousands, except per share amounts)	
Net income	\$ 35,903	30,754
Earnings per share - basic	1.38	1.12
Earnings per share - diluted	1.37	1.11
Return on average assets	1.82%	1.64%
Return on average equity	9.14%	7.60%

## Average Balance Sheets, Interest and Yields/Costs

The following table set forth average balance sheets, annualized average yields and costs, and certain other information for the periods indicated. Non-accrual loans were included in the computation of the average balances of loans receivable and held for sale. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense. Yields on interest-earning assets are computed on a fully tax-equivalent yield, where applicable.

	Years Ended December 31,								
	2019			2018			2017		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
	(Dollars in Thousands)								
<b>Interest-earning assets:</b>									
Loans receivable and held for sale <sup>(1)</sup>	\$ 1,546,249	72,235	4.67%	\$ 1,463,730	66,966	4.58%	\$ 1,369,072	60,824	4.44%
Mortgage related securities <sup>(2)</sup>	113,659	2,978	2.62%	110,136	2,648	2.40%	123,972	2,646	2.13%
Debt securities, federal funds sold and short-term investments <sup>(2)(3)</sup>	181,897	4,826	2.65%	178,594	4,399	2.46%	198,962	4,317	2.17%
Total interest-earning assets	1,841,805	80,039	4.35%	1,752,460	74,013	4.22%	1,692,006	67,787	4.01%
Noninterest-earning assets	131,168			118,737			118,228		
Total assets	\$ 1,972,973			\$ 1,871,197			\$ 1,810,234		
<b>Interest-bearing liabilities:</b>									
Demand accounts	\$ 36,926	33	0.09%	\$ 37,388	33	0.09%	\$ 36,716	28	0.08%
Money market, savings, and escrow accounts	198,027	1,247	0.63%	172,760	599	0.35%	171,307	401	0.23%
Time deposits	737,397	15,998	2.17%	709,102	10,995	1.55%	671,982	7,310	1.09%
Total interest-bearing deposits	972,350	17,278	1.78%	919,250	11,627	1.26%	880,005	7,739	0.88%
Borrowings	484,801	10,266	2.12%	427,301	7,896	1.85%	403,163	8,623	2.14%
Total interest-bearing liabilities	1,457,151	27,544	1.89%	1,346,551	19,523	1.45%	1,283,168	16,362	1.28%
<b>Noninterest-bearing liabilities</b>									
Non-interest bearing deposits	90,497			96,648			89,785		
Other non-interest bearing liabilities	32,594			23,168			26,345		
Total non-interest bearing liabilities	123,091			119,816			116,130		
Total liabilities	1,580,242			1,466,367			1,399,298		
Equity	392,731			404,830			410,936		
Total liabilities and equity	\$ 1,972,973			\$ 1,871,197			\$ 1,810,234		
Net interest income / Net interest rate spread <sup>(4)</sup>		52,495	2.46%		54,490	2.77%		51,425	2.73%
Less: taxable equivalent adjustment		298	0.02%		313	0.02%		692	0.04%
Net interest income / Net interest rate spread, as reported		52,197	2.44%		54,177	2.75%		50,733	2.69%
Net interest-earning assets <sup>(5)</sup>	\$ 384,654			\$ 405,909			\$ 408,838		
Net interest margin <sup>(6)</sup>			2.83%			3.09%			3.00%
Tax equivalent effect			0.02%			0.02%			0.04%
Net interest margin on a fully tax equivalent basis			2.85%			3.11%			3.04%
Average interest-earning assets to average interest-bearing liabilities	126.40%			130.14%			131.86%		

(1) Includes net deferred loan fee amortization income of \$672,000, \$622,000 and \$689,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

(2) Includes available for sale securities.

(3) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 21% for the years ended December 31, 2019 and 2018, and 35% for the year ended December 31, 2017. The yields on debt securities, federal funds sold and short-term investments before tax-equivalent adjustments were 2.49%, 2.29%, and 1.82% for the years ended December 31, 2019, 2018, and 2017, respectively.

(4) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities and is presented on a fully tax equivalent basis.

(5) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(6) Net interest margin represents net interest income divided by average total interest-earning assets.

## Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income for the periods indicated. 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 prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Years Ended December 31, 2019 versus 2018			Years Ended December 31, 2018 versus 2017		
	Increase (Decrease) due to			Increase (Decrease) due to		
	Volume	Rate	Net	Volume	Rate	Net
	(In Thousands)					
Interest and dividend income:						
Loans receivable and held for sale <sup>(1)</sup> <sup>(2)</sup>	\$ 4,045	\$ 1,224	\$ 5,269	\$ 4,244	\$ 1,898	\$ 6,142
Mortgage related securities <sup>(3)</sup>	83	247	330	(313)	315	2
Other interest-earning assets <sup>(3)</sup> <sup>(4)</sup>	79	348	427	(465)	547	82
Total interest-earning assets	4,207	1,819	6,026	3,466	2,760	6,226
Interest expense:						
Demand accounts	-	-	-	-	5	5
Money market, savings, and escrow accounts	100	548	648	4	194	198
Time deposits	454	4,549	5,003	376	3,309	3,685
Total interest-bearing deposits	554	5,097	5,651	380	3,508	3,888
Borrowings	1,137	1,233	2,370	575	(1,302)	(727)
Total interest-bearing liabilities	1,691	6,330	8,021	955	2,206	3,161
Net change in net interest income	\$ 2,516	\$ (4,511)	\$ (1,995)	\$ 2,511	\$ 554	\$ 3,065

(1) Includes net deferred loan fee amortization income of \$672,000, \$622,000 and \$689,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

(2) Non-accrual loans have been included in average loans receivable balance.

(3) Includes available for sale securities.

(4) Interest income from tax exempt securities is computed on a taxable equivalent basis using a tax rate of 21% for the year ended December 31, 2019 and 2018, and 35% for the year ended December 31, 2017.

## Net Interest Income

Net interest income decreased \$2.0 million, or 3.7%, to \$52.2 million during the year ended December 31, 2019 compared to \$54.2 million during the year ended December 31, 2018.

- Interest income on loans increased \$5.3 million due primarily to an increase of \$82.5 million, or 5.6%, in average balance of loans along with a nine basis point increase in average yield on loans. The increase in average loan balance was driven by a \$44.4 million, or 3.3%, increase in the average balance of loans held in portfolio and by an increase of \$38.1 million, or 29.4%, in the average balance of loans held for sale.
- Interest income from mortgage-related securities increased \$330,000 primarily because the average yield increased 22 basis points. Additionally, the average balance of mortgage related securities increased \$3.5 million.
- Interest income from other interest-earning assets (comprised of debt securities, federal funds sold and short-term investments) increased \$442,000 due to a 20 basis point increase in the average yield. The increase in average yield was primarily driven by the increase in the dividend paid by the FHLB on its stock. The average balance increased \$3.3 million to \$181.9 million due to a higher cash balance on hand along with a higher FHLB stock balance offset primarily by a lower balance of municipal securities as maturities occurred throughout the past 12 months were not replaced due to market conditions.
- Interest expense on time deposits increased \$5.0 million, or 45.5%, primarily due to a 62 basis point increase in the average cost of time deposits, as maturing time deposits repriced or were replaced at a higher rate in the current competitive market. In addition to the increase in the average cost of time deposits, the average balance of time deposits increased \$28.3 million compared to the prior year period.
- Interest expense on money market, savings, and escrow accounts increased \$648,000, or 108.2%, due primarily to a 28 basis point increase in the average cost of money market, savings, and escrow accounts along with an increase in average balance of \$25.3 million.
- Interest expense on borrowings increased \$2.4 million, or 30.0%, due to an increase in the average cost of borrowings that resulted from the maturity and replacement of fixed-rate borrowings since the beginning of the prior year. The average cost of borrowings totaled 2.12% for the year ended December 31, 2019, compared to 1.85% during the year ended December 31, 2018. In addition to the increase in rate, average borrowing volume increased \$57.5 million to \$484.8 million during the year ended December 31, 2019.

## Provision for Loan Losses

Our provision for loan losses amounted to a negative provision of \$900,000 during the year ended December 31, 2019, compared to a negative provision of \$1.1 million during the year ended December 31, 2018. We had a negative provision for loan losses of \$1.1 million at the community banking segment due to recoveries and a continued improvement in the overall risk profile of the loan portfolio. A provision for loan losses of \$150,000 for the mortgage banking segment was due to loans added to its loan portfolio.

The provision is primarily a function of the Company's reserving methodology and assessments of certain quantitative and qualitative factors which are used to determine an appropriate allowance for loan losses for the period. See further discussion regarding the allowance for loan losses in the "Asset Quality" section for an analysis of charge-offs, nonperforming assets, specific reserves and additional provisions and the "Allowance for Loan Loss" section.

## Noninterest Income

	Years Ended December 31,		<u>\$ Change</u>	<u>% Change</u>
	<u>2019</u>	<u>2018</u>		
				(Dollars in Thousands)
Service charges on loans and deposits	\$ 2,363	1,680	683	40.7%
Increase in cash surrender value of life insurance	1,935	1,848	87	4.7%
Mortgage banking income	125,666	113,151	12,515	11.1%
Other	786	1,520	(734)	(48.3%)
Total noninterest income	\$ 130,750	118,199	12,551	10.6%

Total noninterest income increased \$12.6 million, or 10.6%, to \$130.8 million during the year ended December 31, 2019 compared to \$118.2 million during the year ended December 31, 2018. The increase resulted primarily from an increase in mortgage banking income, partially offset by a decrease in other noninterest income.

- The \$12.6 million increase in mortgage banking income was primarily the result of an increase in loan origination volume. Total loan origination volume on a consolidated basis increased \$343.4 million, or 13.7%, to \$2.85 billion during the year ended December 31, 2019 compared to \$2.51 billion during the year ended December 31, 2018. Gross margin on loans originated and sold decreased 1.9% at the mortgage banking segment. Gross margin on loans originated and sold is the ratio of mortgage banking income (excluding the change in interest rate lock fair value) divided by total loan originations. See "Comparison of Mortgage Banking Segment Results of Operations for the Year December 31, 2019 and 2018" above, for additional discussion of the increase in mortgage banking income.
- The increase in service charges on loans and deposits was due to an increase of loan prepayment penalties on existing loans. Additionally, the Bank received fees for originating loan interest rate swaps which began in the current year.
- The increase in cash surrender value of life insurance was due primarily to an increase in earnings rate.
- The \$734,000 decrease in other noninterest income was primarily due to a decrease in gain on sale of mortgage servicing rights. A bulk sale of mortgage servicing rights resulted in a gain of \$417,000 during the year ended December 31, 2018. There were no sales during the year ended December 31, 2019. In addition to the decrease from the gain on sale of mortgage servicing rights, other noninterest income decreased due to less servicing fee income on loans sold and rental income.

### Noninterest Expenses

	Years Ended December 31,		\$ Change	% Change
	2019	2018		
	(Dollars in Thousands)			
Compensation, payroll taxes, and other employee benefits	\$ 101,718	97,784	3,934	4.0%
Occupancy, office furniture and equipment	10,606	10,855	(249)	(2.3%)
Advertising	3,885	4,123	(238)	(5.8%)
Data processing	3,630	2,792	838	30.0%
Communications	1,359	1,611	(252)	(15.6%)
Professional fees	3,605	2,327	1,278	54.9%
Real estate owned	(146)	1	(147)	(14,700.0%)
Loan processing expense	3,288	3,372	(84)	(2.5%)
Other	8,328	10,291	(1,963)	(19.1%)
Total noninterest expenses	\$ 136,273	133,156	3,117	2.3%



Total noninterest expenses increased \$3.1 million, or 2.3%, to \$136.3 million during the year ended December 31, 2019 compared to \$133.2 million during the year ended December 31, 2018.

- Compensation, payroll taxes and other employee benefit expense at our mortgage banking segment increased \$4.2 million, or 5.3%, to \$84.2 million for the year ended December 31, 2019. The increase in compensation expense was primarily a result of the increase in commission expense as fundings increased and branch manager pay as branches were more profitable. These increases were partially offset by a decrease to salaries as we closed underperforming branches over the past year.
- Compensation, payroll taxes and other employee benefits expense at the community banking segment decreased \$190,000, or 1.0%, to \$18.2 million during the year ended December 31, 2019. The decrease was primarily due to a decrease in health insurance and lower stock based compensation expenses offset by higher variable compensation and salaries expense with annual raises and the addition of two branches.
- Occupancy, office furniture and equipment expense at the mortgage banking segment decreased \$694,000 to \$6.9 million during the year ended December 31, 2019 compared to the prior year resulting from lower computer supplies expense and rent expense due to a number of underperforming branches closing.
- Occupancy, office furniture and equipment expense at the community banking segment increased \$445,000 to \$3.8 million during the year ended December 31, 2019 compared to the prior year. The increase was primarily due to increased depreciation expense, snow removal, maintenance and repair expense, and computer supplies.
- Advertising expense decreased \$238,000 primarily due to less spending at the mortgage banking segment as customer leads were acquired in the New Mexico branch acquisition during the prior year. Offsetting the decrease at the mortgage banking segment, advertising increased slightly at the community banking segment to promote deposit products.
- Data processing expense increased \$838,000 to \$3.6 million during the year ended December 31, 2019. This was primarily due to increases at the community banking and mortgage banking segments for new contracts and investments in technology resources to support future growth.
- Professional fees expense increased \$1.3 million, or 54.9%, to \$3.6 million primarily as a result of an increase in legal fees at the mortgage banking segment for ongoing litigation partially offset by lower consulting fees at the community banking segment.
- Real estate owned expense decreased \$147,000, to \$146,000 of income during the year ended December 31, 2019 compared to \$1,000 of expense during the year ended December 31, 2018. Property management expense, not including gains/losses on sales of real estate owned, decreased \$108,000 to \$158,000 during 2019 compared to 2018 due to a reduction in the number of properties under management during the year. Real estate owned writedowns decreased \$308,000 as there were no writedowns for 2019. Net gains on sales of real estate owned decreased \$270,000 to \$304,000 during 2019.
- Loan processing expense decreased \$84,000 to \$3.3 million during the year ended December 31, 2019. This was driven by an decrease in credit report fees at the mortgage banking segment.
- Other noninterest expense decreased \$2.0 million to \$8.3 million primarily due to lower expenses at both the community banking and mortgage banking segments. At the community banking segment, other noninterest expense decreased \$510,000 primarily due to a decrease in loan origination expenses and FDIC insurance expense as two credits were granted in 2019. At the mortgage banking segment, other noninterest expenses decreased \$1.8 million primarily due to lower branch loss reserves as underperforming branches were closed as well as lower hiring, training, and recruiting expenses partially offset by an increase in provision for loan sale losses.

### **Income Taxes**

Income tax expense increased \$2.1 million to \$11.7 million during the year ended December 31, 2019, compared to \$9.5 million during the year ended December 31, 2018. Income tax expense was recognized during the year ended December 31, 2019 at an effective rate of 24.5% compared to an effective rate of 23.6% during the year ended December 31, 2018. During the year ended December 31, 2019, the Company recognized a benefit of approximately \$114,000 related to stock awards exercised compared to a benefit of \$197,000 recognized during the year ended December 31, 2018.

## Liquidity and Capital Resources

We maintain liquid assets at levels we consider adequate to meet our liquidity needs. The liquidity ratio is equal to average daily cash and cash equivalents for the period divided by average total assets. We adjust our liquidity levels to fund loan commitments, repay our borrowings, fund deposit outflows and pay real estate taxes on mortgage loans. We also adjust liquidity as appropriate to meet asset and liability management objectives. The operational adequacy of our liquidity position at any point in time is dependent upon the judgment of the Chief Financial Officer as supported by the Asset/Liability Committee. Liquidity is monitored on a daily, weekly and monthly basis using a variety of measurement tools and indicators. Regulatory liquidity, as required by the WDFI, is based on current liquid assets as a percentage of the prior month's average deposits and short-term borrowings. Minimum primary liquidity is equal to 4.0% of deposits and short-term borrowings and minimum total regulatory liquidity is equal to 8.0% of deposits and short-term borrowings. The Bank's primary and total regulatory liquidity at December 31, 2019 were 10.9% and 21.7%, respectively.

Our primary sources of liquidity are deposits, amortization and repayment of loans, sales of loans held for sale, maturities of investment securities and other short-term investments, and earnings and funds provided from operations. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows and loan repayments are greatly influenced by market interest rates, economic conditions, and rates offered by our competitors. We set the interest rates on our deposits to maintain a desired level of total deposits. In addition, we invest excess funds in short-term, interest-earning assets, which provide liquidity to meet lending requirements. Additional sources of liquidity used to manage long- and short-term cash flows include advances from the FHLB.

A portion of our liquidity consists of cash and cash equivalents, which are a product of our operating, investing and financing activities. At December 31, 2019 and 2018, \$74.3 million and \$86.1 million, respectively, of our assets were invested in cash and cash equivalents. Our primary sources of cash are principal repayments on loans, proceeds from the calls and maturities of debt and mortgage related securities, increases in deposit accounts, Federal funds purchased and advances from the FHLB.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included in our Consolidated Financial Statements.

During the years ended December 31, 2019, and 2018, we originated \$2.85 billion and \$2.51 billion in loans for sale and sold loans of \$2.90 billion and \$2.63 billion. During the years ended December 31, 2019, and 2018, loan originations net of loan repayments resulted in a negative cash flows of \$9.9 million and \$87.6 million. Cash received from the principal repayments of debt and mortgage related securities and maturity and calls of debt securities totaled \$40.0 million and \$39.0 million for the years ended December 31, 2019 and 2018, respectively. We purchased \$28.9 million and \$28.1 million in debt securities and mortgage related securities classified as available for sale during the years ended December 31, 2019 and 2018, respectively. The net increases in deposits were \$29.3 million and \$71.1 million for the years ending December 31, 2019 and 2018. We received a \$474,000 death benefit on a bank owned life insurance policy in 2018. There was a net increase in borrowings of \$48.5 million and \$48.8 million for the years ended December 31, 2019 and 2018. During the years ended December 31, 2019 and 2018, we repurchased common stock of \$22.8 million and \$19.2 million, respectively. During the years ended December 31, 2019 and 2018, we paid cash dividends on common stock of \$26.0 million and \$27.1 million, respectively.

Deposits increased by \$29.3 million from December 31, 2018 to December 31, 2019. The increase was driven by an increase of \$34.4 million in money market and savings deposits and \$3.9 million in time deposits offset by a decrease of \$9.0 million in demand deposits. Deposit flows are generally affected by the level of interest rates, market conditions and products offered by local competitors and other factors.

Liquidity management is both a daily and longer-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLB which provide an additional source of funds. At December 31, 2019, we had \$470.0 million in long term advances from the FHLB with contractual maturity dates in 2027, 2028, and 2029. The 2027 advance has a contractual maturity date in December 2027. The 2028 advance maturities have single call options in March 2020, March 2021, May 2020, and May 2021, along with two advances that have quarterly call options beginning in June 2020 and September 2020. The 2029 advance maturities have quarterly call option currently available and the other options beginning November 2020, August 2021, and May 2022. As an additional source of funds, the mortgage banking segment has a repurchase agreement. At December 31, 2019, we had \$13.6 million outstanding under the repurchase agreement with a total outstanding commitment of \$35.0 million.

At December 31, 2019, we had outstanding commitments to originate loans receivable of \$13.4 million. In addition, at December 31, 2019, we had unfunded commitments under construction loans of \$90.4 million, unfunded commitments under business lines of credit of \$14.6 million and unfunded commitments under home equity lines of credit and standby letters of credit of \$14.7 million. At December 31, 2019, certificates of deposit scheduled to mature in less than one year totaled \$665.7 million. Based on prior experience, management believes that a significant portion of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits are not retained by us, we will have to utilize other funding sources, such as Federal Home Loan Bank of Chicago advances, Federal Reserve Discount Window or brokered deposits to maintain our level of assets. However, such borrowings may not be available on attractive terms, or at all, if and when needed. Alternatively, we would reduce our level of liquid assets, such as our cash and cash equivalents and securities available for sale in order to meet funding needs. In addition, the cost of such deposits may be significantly higher if market interest rates are higher or there is an increased amount of competition for deposits in our market area at the time of renewal.

Waterstone Financial, Inc. and WaterStone Bank are subject to various regulatory capital requirements, 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 assets and off-balance sheet items to broad risk categories. At December 31, 2019, Waterstone Financial, Inc. and WaterStone Bank exceeded all regulatory capital requirements and is considered "well capitalized" under regulatory guidelines. See "Supervision and Regulation—Capital Requirements" and Note 9 of the notes to the consolidated financial statements.

## Capital

Shareholders' equity decreased \$6.0 million, or 1.5%, to \$393.7 million at December 31, 2019 from \$399.7 million at December 31, 2018. Shareholders' equity decreased primarily due to the declaration of regular dividends and a special dividend and the repurchase of stock. Partially offsetting the decreases were increases from net income, stock options exercised, the increase in the fair value of the securities portfolio, and unearned ESOP shares as they continue to vest.

The Company's Board of Directors authorized a stock repurchase program in the second quarter of 2019. The timing of the repurchases will depend on certain factors, including but not limited to, market conditions and prices, available funds and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions and pursuant to a trading plan that will be adopted in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934. Repurchased shares are held by the Company as authorized but unissued shares.

The Company had repurchased 8,379,303 shares at an average price of \$14.11 under previously approved stock repurchase plans as of December 31, 2019. The Company is authorized to purchase up to 1.3 million additional shares under the current approved stock repurchase program as of December 31, 2019. The Company also repurchased shares for minimum tax withholding settlements on equity compensation. These purchases are not included in the 8,379,303 total above and do not count against the maximum number of shares that may yet be purchased under the Board of Directors' authorization.

## Contractual Obligations, Commitments, Contingent Liabilities, and Off-balance Sheet Arrangements

WaterStone Bank has various financial obligations, including contractual obligations and commitments that may require future cash payments. The following tables present information indicating various non-deposit contractual obligations and commitments of WaterStone Bank as of December 31, 2019 and the respective maturity dates.

### Contractual Obligations

	<u>Total</u>	<u>One Year or Less</u>	<u>More Than One Year Through Three Years</u>	<u>More Than Three Years Through Five Years</u>	<u>Over Five Years</u>
	(In Thousands)				
Deposits without a stated maturity <sup>(1)</sup>	\$ 332,217	\$ 332,217	\$ -	\$ -	\$ -
Time deposit <sup>(1)</sup>	739,771	665,703	72,401	1,667	-
Repurchase agreements <sup>(1)</sup>	13,562	13,562	-	-	-
Federal Home Loan Bank advances <sup>(2)</sup>	470,000	-	-	-	470,000
Operating leases <sup>(3)</sup>	10,238	3,308	4,173	1,774	983
Total Contractual Obligations	<u>\$ 1,565,788</u>	<u>\$ 1,014,790</u>	<u>\$ 76,574</u>	<u>\$ 3,441</u>	<u>\$ 470,983</u>

(1) Excludes interest

(2) Secured under a blanket security agreement on qualifying assets, principally, mortgage loans. Excludes interest that will accrue on the advances. See call provisions in Note 8 - Borrowings

(3) Represents non-cancellable operating leases for offices and equipment.

### Other Commitments

	<u>Total</u>	<u>One Year or Less</u>	<u>More than One Year through Three Years</u>	<u>More than Three Years Through Five Years</u>	<u>Over Five Years</u>
	(In Thousands)				
Real estate loan commitments <sup>(1)</sup>	\$ 13,389	\$ 13,389	\$ -	\$ -	\$ -
Unused portion of home equity lines of credit <sup>(2)</sup>	13,776	13,776	-	-	-
Unused portion of construction loans <sup>(3)</sup>	90,439	90,439	-	-	-
Unused portion of business lines of credit	14,623	14,623	-	-	-
Standby letters of credit	885	885	-	-	-

(1) Commitments for loans are extended to customers for up to 90 days after which they expire.

(2) Unused portions of home equity loans are available to the borrower for up to 10 years.

(3) Unused portions of construction loans are available to the borrower for up to one year.

See Note 14 - Commitments, Off-Balance Sheet Arrangements, and Contingent Liabilities of the notes to consolidated financial statements for additional information.

## Impact of Inflation and Changing Prices

The financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than do the effects of inflation.

## Quarterly Financial Information

The following table sets forth certain unaudited quarterly data for the periods indicated:

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands, except per share data)			
<b>2019 (unaudited)</b>				
Interest income	\$ 19,172	\$ 19,913	\$ 20,378	\$ 20,278
Interest expense	6,236	6,932	7,224	7,152
Net interest income	12,936	12,981	13,154	13,126
Provision (credit) for loan losses	(680)	30	(80)	(170)
Net interest income after provision for loan losses	13,616	12,951	13,234	13,296
Total noninterest income	24,257	35,190	37,494	33,809
Total noninterest expense	29,349	35,355	36,232	35,337
Income before income taxes	8,524	12,786	14,496	11,768
Income taxes	1,982	3,143	3,572	2,974
Net income	\$ 6,542	\$ 9,643	\$ 10,924	\$ 8,794
Income per share – basic	\$ 0.25	\$ 0.37	\$ 0.42	\$ 0.34
Income per share - diluted	\$ 0.24	\$ 0.37	\$ 0.42	\$ 0.34
<b>2018 (unaudited)</b>				
Interest income	\$ 16,963	\$ 18,363	\$ 19,046	\$ 19,328
Interest expense	3,822	4,643	5,196	5,862
Net interest income	13,141	13,720	13,850	13,466
Provision (credit) for loan losses	(880)	(220)	40	-
Net interest income after provision for loan losses	14,021	13,940	13,810	13,466
Total noninterest income	25,183	33,318	34,062	25,636
Total noninterest expense	30,147	34,737	36,426	31,846
Income before income taxes	9,057	12,521	11,446	7,256
Income taxes	2,104	3,101	2,743	1,578
Net income	\$ 6,953	\$ 9,420	\$ 8,703	\$ 5,678
Income per share – basic	\$ 0.25	\$ 0.34	\$ 0.32	\$ 0.21
Income per share - diluted	\$ 0.25	\$ 0.34	\$ 0.31	\$ 0.21

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

### Management of Market Risk

**General.** The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, WaterStone Bank's board of directors has established an Asset/Liability Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the board of directors. Management monitors the level of interest rate risk on a regular basis and the Asset/Liability Committee meets at least weekly to review our asset/liability policies and interest rate risk position, which are evaluated quarterly.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. We have implemented the following strategies to manage our interest rate risk: (i) emphasizing variable rate loans including variable rate one- to four-family, and commercial real estate loans as well as three to five year commercial real estate balloon loans; (ii) reducing and shortening the expected average life of the investment portfolio; and (iii) whenever possible, lengthening the term structure of our deposit base and our borrowings from the FHLBC. These measures should reduce the volatility of our net interest income in different interest rate environments.

**Income Simulation.** Simulation analysis is an estimate of our interest rate risk exposure at a particular point in time. At least quarterly we review the potential effect changes in interest rates may have on the repayment or repricing of rate sensitive assets and funding requirements of rate sensitive liabilities. Our most recent simulation uses projected repricing of assets and liabilities at December 31, 2019 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rate assumptions may have a significant impact on interest income simulation results. Because of the large percentage of loans and mortgage-backed securities we hold, rising or falling interest rates may have a significant impact on the actual prepayment speeds of our mortgage related assets that may in turn affect our interest rate sensitivity position. When interest rates rise, prepayment speeds slow and the average expected lives of our assets would tend to lengthen more than the expected average lives of our liabilities and therefore would most likely have a positive impact on net interest income and earnings.

The following interest rate scenario displays the percentage change in net interest income over a one-year time horizon assuming increases of 100, 200 and 300 basis points and a decrease of 100 basis points. The results incorporate actual cash flows and repricing characteristics for balance sheet accounts following an instantaneous parallel change in market rates based upon a static (no growth balance sheet).

#### Analysis of Net Interest Income Sensitivity

	Immediate Change in Rates			
	+300	+200	+100	-100
As of December 31, 2019				
Dollar Change	\$ 886	1,209	1,047	(1,440)
Percentage Change	1.72%	2.35	2.03	(2.80)

At December 31, 2019, a 100 basis point instantaneous increase in interest rates had the effect of increasing forecast net interest income over the next 12 months by 2.03% while a 100 basis point decrease in rates had the effect of decreasing net interest income by 2.80%.

**Item 8. Financial Statements and Supplementary Data**

**Report of Independent Registered Public Accounting Firm**

To the Shareholders and the Board of Directors of Waterstone Financial, Inc.

**Opinion on the Financial Statements**

We have audited the accompanying consolidated statements of financial condition of Waterstone Financial, Inc. and Subsidiaries (the Company) as of December 31, 2019 and 2018, the related consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2019, and the related notes to the consolidated financial statements (collectively, 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, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

We have also 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, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 13, 2020 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

**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 PCAOB and are required to be independent with respect to the Company in accordance with 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 audits 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.

/s/ RSM US LLP

We have served as the Company's auditor since 2014.

Chicago, Illinois  
March 13, 2020

**Waterstone Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Financial Condition**  
**December 31, 2019 and 2018**

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Assets</b>	(In Thousands, except share data)	
Cash	\$ 52,814	48,234
Federal funds sold	12,704	25,100
Interest-earning deposits in other financial institutions and other short term investments	8,782	12,767
Cash and cash equivalents	74,300	86,101
Securities available for sale (at fair value)	178,476	185,720
Loans held for sale (at fair value)	220,123	141,616
Loans receivable	1,388,031	1,379,148
Less: Allowance for loan losses	12,387	13,249
Loans receivable, net	1,375,644	1,365,899
Office properties and equipment, net	25,028	24,524
Federal Home Loan Bank stock (at cost)	21,150	19,350
Cash surrender value of life insurance	69,665	67,550
Real estate owned, net	748	2,152
Prepaid expenses and other assets	31,213	22,469
Total assets	\$ 1,996,347	1,915,381
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities:</b>		
Demand deposits	\$ 130,063	139,111
Money market and savings deposits	197,942	163,511
Time deposits	739,771	735,873
Total deposits	1,067,776	1,038,495
Borrowings	483,562	435,046
Advance payments by borrowers for taxes	4,212	4,371
Other liabilities	47,111	37,790
Total liabilities	1,602,661	1,515,702
<b>Shareholders' equity:</b>		
Preferred stock (par value \$.01 per share) Authorized - 50,000,000 shares in 2019 and 2018, no shares issued	-	-
Common stock (par value \$.01 per share) Authorized - 100,000,000 shares in 2019 and 2018 Issued - 27,148,411 in 2019 and 28,463,239 in 2018 Outstanding - 27,148,411 in 2019 and 28,463,239 in 2018	271	285
Additional paid-in capital	211,997	232,406
Retained earnings	197,393	187,153
Unearned ESOP shares	(16,617)	(17,804)
Accumulated other comprehensive income (loss), net of taxes	642	(2,361)
Total shareholders' equity	393,686	399,679
Total liabilities and shareholders' equity	\$ 1,996,347	1,915,381

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Operations**  
**Years ended December 31, 2019, 2018 and 2017**

	<b>Years ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	(In Thousands, except per share amounts)		
<b>Interest income:</b>			
Loans	\$ 72,235	66,966	60,824
Mortgage-related securities	2,978	2,648	2,646
Debt securities, federal funds sold and short-term investments	4,528	4,086	3,625
Total interest income	79,741	73,700	67,095
<b>Interest expense:</b>			
Deposits	17,278	11,627	7,739
Borrowings	10,266	7,896	8,623
Total interest expense	27,544	19,523	16,362
Net interest income	52,197	54,177	50,733
Provision (credit) for loan losses	(900)	(1,060)	(1,166)
Net interest income after provision for loan losses	53,097	55,237	51,899
<b>Noninterest income:</b>			
Service charges on loans and deposits	2,363	1,680	1,625
Increase in cash surrender value of life insurance	1,935	1,848	1,807
Mortgage banking income	125,666	113,151	120,044
Loss on sale of available for sale securities	-	-	(107)
Other	786	1,520	1,044
Total noninterest income	130,750	118,199	124,413
<b>Noninterest expenses:</b>			
Compensation, payroll taxes, and other employee benefits	101,718	97,784	97,084
Occupancy, office furniture, and equipment	10,606	10,855	10,178
Advertising	3,885	4,123	3,333
Data processing	3,630	2,792	2,439
Communications	1,359	1,611	1,560
Professional fees	3,605	2,327	2,656
Real estate owned	(146)	1	379
Loan processing expense	3,288	3,372	3,062
Other	8,328	10,291	11,188
Total noninterest expenses	136,273	133,156	131,879
Income before income taxes	47,574	40,280	44,433
Income tax expense	11,671	9,526	18,469
Net income	\$ 35,903	30,754	25,964
<b>Income per share:</b>			
Basic	\$ 1.38	1.12	0.95
Diluted	\$ 1.37	1.11	0.93
<b>Weighted average shares outstanding:</b>			
Basic	26,021	27,363	27,467
Diluted	26,247	27,634	27,899

*See accompanying notes to consolidated financial statements*



**Waterstone Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Comprehensive Income**  
**Years ended December 31, 2019, 2018 and 2017**

	Years ended December 31,		
	2019	2018	2017
	(In Thousands)		
Net income	\$ 35,903	30,754	25,964
Other comprehensive income (loss), net of tax:			
Net unrealized holding gain (loss) on available for sale securities arising during the period, net of tax (expense) benefit of (\$1,122), \$710 and \$106 respectively	3,003	(1,889)	(159)
Recognition of net deferred tax liability revaluation due to tax law change	-	5	(5)
Reclassification adjustment for net loss on available for sale securities realized during the period, net of tax benefit of \$0, \$0 and (\$42), respectively	-	-	65
Total other comprehensive income (loss)	3,003	(1,884)	(99)
Comprehensive income	\$ 38,906	28,870	25,865

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**Years Ended December 31, 2019, 2018 and 2017**

	<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Unearned ESOP Shares</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>					
Balances at December 31, 2016	29,430	\$ 294	246,387	184,565	(20,178)	(378)	410,690
<b>Comprehensive income:</b>							
Net income	-	\$ -	-	25,964	-	-	25,964
Other comprehensive loss:	-	-	-	-	-	(99)	(99)
Total comprehensive income							25,865
ESOP shares committed to be released to Plan participants	-	-	769	-	1,187	-	1,956
Cash dividends, \$0.98 per share	-	-	-	(27,171)	-	-	(27,171)
Stock compensation activity	194	2	1,050	-	-	-	1,052
Stock based compensation expense	-	-	1,902	-	-	-	1,902
Purchase of common stock returned to authorized but unissued	(123)	(1)	(2,189)	-	-	-	(2,190)
Balances at December 31, 2017	29,501	\$ 295	247,919	183,358	(18,991)	(477)	412,104
<b>Comprehensive income:</b>							
Net income	-	\$ -	-	30,754	-	-	30,754
Other comprehensive loss:	-	-	-	-	-	(1,884)	(1,884)
Total comprehensive income							28,870
Reclassification for net deferred tax liability revaluation	-	-	-	(5)	-	-	(5)
ESOP shares committed to be released to Plan participants	-	-	609	-	1,187	-	1,796
Cash dividends, \$0.98 per share	-	-	-	(26,954)	-	-	(26,954)
Stock compensation activity	103	1	1,303	-	-	-	1,304
Stock based compensation expense	-	-	1,760	-	-	-	1,760
Purchase of common stock returned to authorized but unissued	(1,141)	(11)	(19,185)	-	-	-	(19,196)
Balances at December 31, 2018	28,463	\$ 285	232,406	187,153	(17,804)	(2,361)	399,679
<b>Comprehensive income:</b>							
Net income	-	\$ -	-	35,903	-	-	35,903
Other comprehensive income:	-	-	-	-	-	3,003	3,003
Total comprehensive income							38,906
ESOP shares committed to be released to Plan participants	-	-	618	-	1,187	-	1,805
Cash dividends, \$0.98 per share	-	-	-	(25,663)	-	-	(25,663)
Stock compensation activity	50	-	659	-	-	-	659
Stock based compensation expense	-	-	1,067	-	-	-	1,067
Purchase of common stock returned to authorized but unissued	(1,365)	(14)	(22,753)	-	-	-	(22,767)
Balances at December 31, 2019	27,148	\$ 271	211,997	197,393	(16,617)	642	393,686

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**Years ended December 31, 2019, 2018 and 2017**

	Years ended December 31,		
	2019	2018	2017
	(In Thousands)		
<b>Operating activities:</b>			
Net income	\$ 35,903	30,754	25,964
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
(Credit) provision for loan losses	(900)	(1,060)	(1,166)
Provision for depreciation	2,507	2,296	2,050
Deferred income taxes	639	535	3,079
Stock based compensation	1,067	1,760	1,902
Net amortization of premium/discount on debt and mortgage related securities	205	444	682
Amortization of unearned ESOP shares	1,805	1,796	1,956
Amortization and valuation allowance on mortgage servicing rights	181	191	106
Gain on sale of loans held for sale	(128,928)	(109,526)	(121,951)
Loans originated for sale	(2,853,222)	(2,509,827)	(2,458,370)
Proceeds on sales of loans originated for sale	2,903,643	2,627,634	2,655,673
Increase in accrued interest receivable	(7)	(413)	(643)
Increase in cash surrender value of life insurance	(1,935)	(1,848)	(1,807)
Increase (decrease) in accrued interest on deposits and borrowings	164	509	(30)
Decrease (increase) in prepaid income tax	330	(1,178)	(1,686)
Loss on sale of available for sale securities	-	-	107
Net gain on real estate owned	(304)	(265)	(24)
Gain on sale of mortgage servicing rights	-	(417)	(178)
Change in other assets and other liabilities, net	(1,367)	1,551	1,433
Net cash (used in) provided by operating activities	<u>(40,219)</u>	<u>42,936</u>	<u>107,097</u>
<b>Investing activities:</b>			
Net increase in loans receivable	(9,896)	(87,648)	(116,887)
Net change in FHLB Stock	(1,800)	(2,475)	(3,600)
Purchases of:			
Debt securities	-	-	(6,140)
Mortgage related securities	(28,860)	(28,058)	(16,827)
Premises and equipment, net	(3,114)	(3,962)	(1,577)
Bank owned life insurance	(180)	(180)	(2,680)
Mortgage banking branch	-	(163)	-
Proceeds from:			
Principal repayments on mortgage-related securities	31,944	28,572	32,968
Maturities of debt securities	8,080	10,435	15,686
Sales of debt securities	-	-	448
Death benefit from bank owned life insurance	-	474	-
Sales of real estate owned	2,674	3,134	3,733
Net cash used in investing activities	<u>(1,152)</u>	<u>(79,871)</u>	<u>(94,876)</u>
<b>Financing activities:</b>			
Net increase in deposits	29,281	71,115	17,969
Net change in short term borrowings	8,516	(41,239)	(26,870)
Repayment of long term debt	(125,000)	(165,000)	(149,000)
Proceeds from long term debt	165,000	255,000	175,000
Net (decrease) increase in advance payments by borrowers for taxes	(159)	(505)	160
Cash dividends in common stock	(25,960)	(27,050)	(26,952)
Proceeds from stock option exercises	659	1,304	1,052
Purchase of common stock returned to authorized but unissued	(22,767)	(19,196)	(2,190)
Net cash provided by (used in) financing activities	<u>29,570</u>	<u>74,429</u>	<u>(10,831)</u>
(Decrease) increase in cash and cash equivalents	(11,801)	37,494	1,390
Cash and cash equivalents at beginning of year	86,101	48,607	47,217
Cash and cash equivalents at end of year	<u>\$ 74,300</u>	<u>86,101</u>	<u>48,607</u>
<b>Supplemental information:</b>			
Cash paid or credited during the period for:			
Income tax payments	\$ 10,703	10,168	17,081
Interest payments	27,380	19,014	16,392
Noncash investing activities:			
Loans receivable transferred to other real estate	1,052	545	2,171
Dividends declared but not paid in other liabilities	3,501	3,798	3,894

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**Years ended December 31, 2019, 2018 and 2017**

**1) Summary of Significant Accounting Policies**

The following significant accounting and reporting policies of Waterstone Financial, Inc. and subsidiaries (collectively, the "Company"), conform to U.S. generally accepted accounting principles, or ("GAAP"), and are used in preparing and presenting these consolidated financial statements.

Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications did not result in any changes to previously reported net income. The Company reclassified the Cost of Shares Repurchased line item presented in prior periods to the Additional Paid in Capital line item in the Consolidated Statements of Financial Condition. The Cost of Shares Repurchased column was reclassified to the Additional Paid in Capital line in the Consolidated Statements of Changes in Shareholders' Equity.

**a) Nature of Operations**

The Company is a one-bank holding company with two operating segments – community banking and mortgage banking. WaterStone Bank SSB (the "Bank" or "WaterStone Bank") is principally engaged in the business of attracting deposits from the general public and using such deposits to originate real estate, business and consumer loans.

The Bank provides a full range of financial services to customers through branch locations in southeastern Wisconsin. In addition, the Bank has a loan production office in Minneapolis, Minnesota. The Bank is subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

The Bank owns a mortgage banking subsidiary that originates residential real estate loans held for sale at various branch offices across the country. Mortgage banking volume fluctuates widely in connection with movements in interest rates. Mortgage banking income is reported as a single line item in the statements of operations while mortgage banking expense is distributed among the various noninterest expense lines. Compensation, payroll taxes and other employee benefits expense fluctuates in relation to fluctuations in mortgage banking income.

**b) Principles of Consolidation**

The consolidated financial statements include the accounts and operations of Waterstone Financial, Inc. and its wholly owned subsidiary, WaterStone Bank. The Bank has the following wholly owned subsidiaries: Wauwatosa Investments, Inc., Waterstone Mortgage Corporation, and Main Street Real Estate Holdings, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

**c) Use of Estimates**

The preparation of the consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include: the allowance for loan losses, income taxes, and fair value measurements.

**e) Cash and Cash Equivalents**

The Company considers federal funds sold and highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents.

**e) Securities**

*Available for Sale Securities*

At the time of purchase, investment securities are classified as available for sale, as management has the intent and ability to hold such securities for an indefinite period of time, but not necessarily to maturity. Any decision to sell investment securities available for sale would be based on various factors, including, but not limited to asset/liability management strategies, changes in interest rates or prepayment risks, liquidity needs, or regulatory capital considerations. Available for sale securities are carried at fair value, with the unrealized gains and losses, net of deferred tax, reported as a separate component of equity in accumulated other comprehensive income (loss). The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity or, in the case of mortgage-backed securities and collateralized mortgage obligations, over the estimated life of the security. Such amortization or accretion is included in interest income from securities. Realized gains or losses on securities sales (using specific identification method) are included in noninterest income. Declines in value judged to be other than temporary are included in net impairment losses recognized in earnings in the consolidated statements of operations.

### *Other Than Temporary Impairment*

One of the significant estimates related to securities is the evaluation of investments for other than temporary impairment. The Company assesses investment securities with unrealized loss positions for other than temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either temporary or other than temporary. In evaluating other than temporary impairment, management considers the length of time and extent to which the fair value has been less than cost and the expected recovery period of the security, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. Declines in the fair value of investment securities below amortized cost are deemed to be other than temporary when the Company cannot assert that it will recover its amortized cost basis, including whether the present value of cash flows expected to be collected is less than the amortized cost basis of the security. If it is more likely than not that the Company will be required to sell the security before recovery or if the Company has the intent to sell, an other than temporary impairment write down is recognized in earnings equal to the difference between the security's amortized cost and its fair value. If it is not more likely than not that the Company will be required to sell the security before recovery and if the Company does not intend to sell, the other than temporary impairment write down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to other factors, which is recognized as a separate component of equity. Following the recognition of an other than temporary impairment representing credit loss, the book value of an investment less the impairment loss realized becomes the new cost basis. The determination as to whether an other than temporary impairment exists and, if so, the amount considered other than temporarily impaired, or not impaired, is subjective and, therefore, the timing and amount of other than temporary impairments constitute material estimates that are subject to significant change.

### *Federal Home Loan Bank Stock*

Federal Home Loan Bank ("FHLB") stock is carried at cost, which is the amount that the stock is redeemable by tendering to the FHLB or the amount at which shares can be sold to other FHLB members.

### **f) *Loans Held for Sale***

The origination of residential real estate loans is an integral component of the business of the Company. The Company generally sells its originations of long-term fixed interest rate mortgage loans in the secondary market, and on a selective basis, retains the rights to service the loans sold. Gains and losses on the sales of these loans are determined using the specific identification method. Mortgage loans originated for sale are generally sold within 45 days after closing.

The Company has elected to carry loans held for sale at fair value. Fair value is generally determined by estimating a gross premium or discount, which is derived from pricing currently observable in the market. The amount by which cost differs from market value is accounted for as a valuation adjustment to the carrying value of the loans. Changes in value are included in mortgage banking income in the consolidated statements of operations.

Costs to originate loans held for sale are expensed as incurred and are included on the appropriate noninterest expense lines of the statements of operations. Salaries, commissions and related payroll taxes are the primary costs to originate and comprised approximately 74.6% of total mortgage banking noninterest expense for 2019.

The value of mortgage loans held for sale and other residential mortgage loan commitments to customers are hedged by utilizing both best efforts and mandatory forward commitments to sell loans to investors in the secondary market. Such forward commitments are generally entered into at the time when applications are taken to protect the value of the mortgage loans from increases in market interest rates during the period held. The Company recognizes revenue associated with the expected future cash flows of servicing loans at the time a forward loan commitment is made.

### **g) *Loans Receivable and Related Interest Income***

Loans are classified as held for investment when management has both the intent and ability to hold the loan for the foreseeable future, or until maturity or payoff. Loans are carried at the principal amount outstanding, net of any unearned income, charge-offs and unamortized deferred fees and costs. Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of the related loan yield. Amortization is based on a level-yield method over the contractual life of the related loans or until the loan is paid in full.

Loan interest income is recognized on the accrual basis. Accrual of interest is generally discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal, or when a loan becomes contractually past due 90 days or more with respect to interest or principal. At that time, previously accrued and uncollected interest on such loans is reversed and additional income is recorded only to the extent that payments are received and the collection of principal is reasonably assured. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

A loan is accounted for as a troubled debt restructuring if the Company, for economic reasons related to the borrower's financial condition, grants a concession to the borrower that it would not otherwise consider. A troubled debt restructuring typically involves a modification of terms such as a reduction of the stated interest rate, a deferral of principal payments or a combination of both for a temporary period of time. If the borrower was performing in accordance with the original contractual terms at the time of the restructuring, the restructured loan is accounted for on an accruing basis as long as the borrower continues to comply with the modified terms. If the loan was not accounted for on an accrual basis at the time of restructuring, the restructured loan remains in non-accrual status until the loan completes a minimum of six consecutive contractual payments.

***h) Allowance for Loan Losses***

The allowance for loan losses is presented as a reserve against loans and represents the Company's assessment of probable loan losses inherent in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Estimated loan losses are charged against the allowance when the loan balance is confirmed to be uncollectible directly or indirectly by the borrower or upon initiation of a foreclosure action by the Company. Subsequent recoveries, if any, are credited to the allowance.

The allowance provides for probable losses that have been identified with specific customer relationships and for probable losses believed to be inherent in the loan portfolio, but have not been specifically identified. The Company utilizes its own loss history to estimate inherent losses on loans. Although the Bank allocates portions of the allowance to specific loans and loan types, the entire allowance is available for any loan losses that occur.

The Company evaluates the need for specific valuation allowances on loans that are considered impaired. A loan is considered impaired when, based on current information and events, it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. Within the loan portfolio, all non-accrual loans and loans modified under troubled debt restructurings have been determined by the Company to meet the definition of an impaired loan. In addition, other loans may be considered impaired loans. A valuation allowance is established for an amount equal to the impairment when the carrying amount of the loan exceeds the present value of the expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral.

The Company also establishes valuation allowances based on an evaluation of the various risk components that are inherent in the loan portfolio. The risk components that are evaluated include past loan loss experience; the level of non-performing and classified assets; current economic conditions; volume, growth, and composition of the loan portfolio; adverse situations that may affect the borrower's ability to repay; the estimated value of any underlying collateral; regulatory guidance; and other relevant factors.

The appropriateness of the allowance for loan losses is approved quarterly by the Company's board of directors. The allowance reflects management's best estimate of the amount needed to provide for the probable loss on impaired loans, as well as other credit risks of the Company, and is based on a risk model developed and implemented by management and approved by the Company's board of directors.

Actual results could differ from this estimate, and future additions to the allowance may be necessary based on unforeseen changes in economic conditions. In addition, federal regulators periodically review the Company's allowance for loan losses. Such regulators have the authority to require the Company to recognize additions to the allowance at the time of their examination.

***i) Real Estate Owned***

Real estate owned consists of properties acquired through, or in lieu of, loan foreclosure. Real estate owned is transferred into the portfolio at estimated net realizable value. To the extent that the net carrying value of the loan exceeds the estimated fair value of the property at the date of transfer, the excess is charged to the allowance for loan losses within 90 days of being transferred. Subsequent write-downs to reflect current fair value, as well as gains and losses upon disposition and revenue and expenses incurred in maintaining such properties, are treated as period costs and included in real estate owned in the consolidated statements of operations.

***j) Mortgage Servicing Rights***

The Company sells residential mortgage loans in the secondary market and, on a selective basis, retains the right to service the loans sold. Upon sale, a mortgage servicing rights asset is capitalized, which represents the then current fair value of future net cash flows expected to be realized for performing servicing activities. Mortgage servicing rights, when purchased, are initially recorded at fair value. Mortgage servicing rights are amortized over the period of estimated net servicing income, and assessed for impairment at each reporting date. Mortgage servicing rights are carried at the lower of the initial capitalized amount, net of accumulated amortization, or estimated fair value, and are included in other assets, net in the consolidated balance sheets. To the extent that the Company sells mortgage servicing rights, a gain is recognized for the amount of which sale proceeds exceed the remaining unamortized cost of the servicing rights that were sold. Gains on sale of mortgage servicing rights are included in other noninterest income in the consolidated statements of operations.

***k) Cash Surrender Value of Life Insurance***

The Company purchases bank owned life insurance on the lives of certain employees. The Company is the beneficiary of the life insurance policies. The cash surrender value of life insurance is reported at the amount that would be received in cash if the policies were surrendered. Increases in the cash value of the policies and proceeds of death benefits received are recorded in noninterest income. The increase in cash surrender value of life insurance is not subject to income taxes, as long as the Company has the intent and ability to hold the policies until the death benefits are received.

***l) Office Properties and Equipment***

Office properties and equipment, including leasehold improvements and software, are stated at cost, net of depreciation and amortization. Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the lease term, if shorter than the estimated useful life. Maintenance and repairs are charged to expense as incurred, while additions or major improvements are capitalized and depreciated over their estimated useful lives. Estimated useful lives of the assets are 10 to 30 years for office properties, three years to 10 years for equipment, and three years for software.

***m) Income Taxes***

The Company and its subsidiaries file consolidated federal and combined state income tax returns. The provision for income taxes is based upon income in the consolidated financial statements, rather than amounts reported on the income tax returns. 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, as well as net operating loss carry forwards. 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 effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

The Company evaluates the realizability of its deferred tax assets on a quarterly basis. Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is “more likely than not” that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management’s evaluation of both positive and negative evidence, the forecasts of future income, applicable tax planning strategies, and assessments of current and future economic and business conditions.

Positions taken in the Company’s tax returns may be subject to challenge by the taxing authorities upon examination. The benefit of uncertain tax positions are initially recognized in the financial statements only when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. Interest and penalties on income tax uncertainties are classified within income tax expense in the income statement.

***n) Earnings Per Share***

Earnings per share (EPS) are computed using the two-class method. Basic earnings per share is computed by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding adjusted for the dilutive effect of all potential common shares. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised. Shares of the Employee Stock Ownership Plan committed to be released are considered outstanding for both common and diluted EPS.

***o) Comprehensive Income***

Comprehensive income is the total of reported net income and changes in unrealized gains or losses, net of tax, on securities available for sale.

***p) Employee Stock Ownership Plan (ESOP)***

Compensation expense under the ESOP is equal to the fair value of common shares released or committed to be released to participants in the ESOP in each respective period. Common stock purchased by the ESOP and not committed to be released to participants is included in the consolidated statements of financial condition at cost as a reduction of shareholders’ equity.

***q) Share Repurchases***

The Company has a share repurchase program. Repurchases under the repurchase program may be made in the open market, through block trades and other negotiated transactions. The share repurchase program transactions take place primarily in open market transactions, subject to market conditions. There is no fixed termination date for the repurchase program, and the program may be suspended. Under Maryland law, shares repurchased are constituted as authorized but unissued. The Company reduced the common stock at par value and to the extent the cost acquired exceeds par value, it is recorded through additional paid-in capital on the consolidated statements of financial condition and consolidated statements of changes in shareholders’ equity.

r) **Impact of Recent Accounting Pronouncements**

*Accounting Standards Codification (ASC) Topic 606 "Revenue from Contracts with Customers."* Authoritative accounting guidance under ASC Topic 606, "Revenue from Contracts with Customers" amended prior guidance to require an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services and to provide clarification on identifying performance obligations and licensing implementation guidance. The Company's revenue is comprised of interest and non-interest revenue. The guidance does not apply to revenue associated with financial instruments, including loans and securities. The Company completed its overall assessment of revenue streams and related contracts affected by the guidance, including asset management fees, deposit related fees, and other non-interest related fees. The Company adopted ASC 606 as of January 1, 2018 with no impact on total shareholders' equity or net income.

*Revenue Recognition*

- *Debit and credit card interchange fee income* - Card processing fees consist of interchange fees from consumer debit and credit card networks and other card related services. Interchange fees are based on purchase volumes and other factors and are recognized as transactions occur.
- *Service charges on deposit accounts* - Revenue from service charges on deposit accounts is earned through deposit-related services; as well as overdraft, non-sufficient funds, account management and other deposit-related fees. Revenue is recognized for these services either over time, corresponding with deposit accounts' monthly cycle, or at a point in time for transactional related services and fees.
- *Service charges on loan accounts* - Revenue from loan accounts consists primarily of fees earned on prepayment penalties. Revenue is recognized for these services at a point in time for transactional related services and fees.

*ASC Topic 825 "Financial Instruments."* Authoritative accounting guidance under ASC Topic 825, "Financial Instruments" amended prior guidance to require equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. The guidance simplifies the impairment assessment of equity investments without readily determinable fair values, requires public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from changes in the instrument-specific credit risk when the entity has selected the fair value option for financial instruments and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset. The Company adopted ASC 825 as of January 1, 2018 with no material impact on the Company's statements of operations or financial condition.

*ASC Topic 842 "Leases."* Authoritative accounting guidance under ASC Topic 842, "Leases" amended prior guidance to require lessees to recognize the assets and liabilities arising from all leases on the balance sheet. The authoritative guidance defines a lease as a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. In addition, the qualifications for a sale and leaseback transaction have been amended. The authoritative guidance also requires qualitative and quantitative disclosures by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The Company used a prospective approach. The Company adopted ASC 842 as of January 1, 2019 with no impact on statement of operations. See the impact on the financial condition discussed in Note 21.

*ASC Topic 326 "Financial Instruments - Credit Losses."* Authoritative accounting guidance under ASC Topic 326, "Financial Instruments - Credit Losses" amended the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information for credit loss estimates. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The authoritative guidance also requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected (net of the allowance for credit losses). In addition, the credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses rather than a write-down. The authoritative guidance is effective for reporting periods after January 1, 2020.

The Company has input the available historical Company data to build an internal model and is reviewing the assumptions to support the calculation. Management's methodology for estimating the allowance for credit losses under CECL includes the use of relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Historical credit loss experience by vintage classified by loans with similar risk profiles provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are considered for differences in current loan-specific risk characteristics such as changes in underwriting standards, portfolio mix, portfolio volume, delinquency rates, interest rates, or other relevant factors. Management will continue to review and adjust these and other factors. Ongoing evaluations have been performed by vintage adjusted for prepayments. For two portfolio segments, management expects to use a weighted average remaining maturity methodology, which contemplates loss expectations on a pool basis, relying on historic loss rates.

Management is validating the CECL model and methodologies, however we expect an initial increase to the allowance for credit loss, including reserves for unfunded commitments, not to exceed 130% of the December 31, 2019 allowance. When finalized, this one-time increase as a result of the adoption of CECL will be recorded, net of tax, as an adjustment to retained earnings effective January 1, 2020. This estimate is subject to change based on continuing refinement and validation of the model and methodologies.



Financial statement users should be aware that the allowance for credit loss is, by design, inherently sensitive to changes in economic outlook, loan and lease portfolio composition, portfolio duration, and other factors.

*ASC Topic 310 "Receivables - Nonrefundable Fees and Other Costs."* Authoritative accounting guidance under ASC Topic 310 "Receivables - Nonrefundable Fees and Other Costs" amends prior guidance by shortening the amortization period for certain callable debt securities held at a premium requiring the premium to be amortized to the earliest call date. The Company adopted ASC 310 as of January 1, 2019 with no material impact on the Company's statements of operations or financial condition.

*ASC Topic 220 "Income Statement - Reporting Comprehensive Income."* Authoritative accounting guidance under ASC Topic 220 "Income Statement - Reporting Comprehensive Income" allows Companies to make a one-time reclassification from accumulated other comprehensive income (loss) to retained earnings for the effects of remeasuring deferred income taxes originally recorded in other comprehensive income as a result of the change in the federal income tax rate by the Tax Cuts and Jobs Act. The Company adopted this guidance on January 1, 2018 with no impact on total shareholders' equity or net income.

## 2) Securities

### Securities Available for Sale

The amortized cost and fair value of the Company's investment in securities follow:

	<b>December 31, 2019</b>			<b>Fair value</b>
	<b>Amortized cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	
		(In Thousands)		
Mortgage-backed securities	\$ 33,773	422	(45)	34,150
Collateralized mortgage obligations				
Government sponsored enterprise issued	81,232	776	(254)	81,754
Mortgage related securities	115,005	1,198	(299)	115,904
Municipal securities	51,898	1,795	(1)	53,692
Other debt securities	10,000	-	(1,120)	8,880
Debt securities	61,898	1,795	(1,121)	62,572
	<u>\$ 176,903</u>	<u>2,993</u>	<u>(1,420)</u>	<u>178,476</u>
		<b>December 31, 2018</b>		
		(In Thousands)		
Mortgage-backed securities	\$ 42,105	91	(565)	41,631
Collateralized mortgage obligations				
Government sponsored enterprise issued	75,923	243	(1,211)	74,955
Mortgage related securities	118,028	334	(1,776)	116,586
Municipal securities	55,242	825	(119)	55,948
Other debt securities	15,002	-	(1,816)	13,186
Debt securities	70,244	825	(1,935)	69,134
	<u>\$ 188,272</u>	<u>1,159</u>	<u>(3,711)</u>	<u>185,720</u>

The Company's mortgage-backed securities and collateralized mortgage obligations issued by government sponsored enterprises are guaranteed by one of the following government sponsored enterprises: Fannie Mae, Freddie Mac or Ginnie Mae. At December 31, 2019, \$1.2 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities.

The amortized cost and fair value of securities at December 31, 2019, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because issuers or borrowers may have the right to prepay obligations with or without prepayment penalties.

	<b>December 31, 2019</b>	
	<b>Amortized cost</b>	<b>Fair value</b>
	(In Thousands)	
Debt securities:		
Due within one year	\$ 3,449	3,454
Due after one year through five years	33,200	33,843
Due after five years through ten years	14,615	15,618
Due after ten years	10,634	9,657
Mortgage-related securities	115,005	115,904
	<u>\$ 176,903</u>	<u>178,476</u>

Total proceeds and gross gains and losses from sales of investment securities available for sale for each of periods listed below.

	<b>December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	(In Thousands)		
Gross gains	\$ -	-	-
Gross losses	-	-	(107)
Losses on sale of investment securities, net	<u>\$ -</u>	<u>-</u>	<u>(107)</u>
Proceeds from sales of investment securities	\$ -	-	448

Gross unrealized losses on securities available for sale and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows:

	<b>December 31, 2019</b>					
	<b>Less than 12 months</b>		<b>12 months or longer</b>		<b>Total</b>	
	<b>Fair value</b>	<b>Unrealized loss</b>	<b>Fair value</b>	<b>Unrealized loss</b>	<b>Fair value</b>	<b>Unrealized loss</b>
	(In Thousands)					
Mortgage-backed securities	\$ 2,929	(20)	2,849	(25)	5,778	(45)
Collateralized mortgage obligations						
Government sponsored enterprise issued	21,723	(136)	7,180	(118)	28,903	(254)
Municipal securities	100	(1)	-	-	100	(1)
Other debt securities	-	-	8,880	(1,120)	8,880	(1,120)
	<u>\$ 24,752</u>	<u>(157)</u>	<u>18,909</u>	<u>(1,263)</u>	<u>43,661</u>	<u>(1,420)</u>
	<b>December 31, 2018</b>					
	<b>Less than 12 months</b>		<b>12 months or longer</b>		<b>Total</b>	
	<b>Fair value</b>	<b>Unrealized loss</b>	<b>Fair value</b>	<b>Unrealized loss</b>	<b>Fair value</b>	<b>Unrealized loss</b>
	(In Thousands)					
Mortgage-backed securities	\$ 3,036	(9)	33,029	(556)	36,065	(565)
Collateralized mortgage obligations						
Government sponsored enterprise issued	3,079	(13)	47,279	(1,198)	50,358	(1,211)
Municipal securities	7,595	(17)	11,272	(102)	18,867	(119)
Other debt securities	-	-	13,186	(1,816)	13,186	(1,816)
	<u>\$ 13,710</u>	<u>(39)</u>	<u>104,766</u>	<u>(3,672)</u>	<u>118,476</u>	<u>(3,711)</u>

The Company reviews the investment securities portfolio on a quarterly basis to monitor its exposure to other-than-temporary impairment. In evaluating whether a security's decline in market value is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, financial condition of the issuer and the underlying obligors, quality of credit enhancements, volatility of the fair value of the security, the expected recovery period of the security and ratings agency evaluations. In addition, the Company may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds and the value of any underlying collateral.

As of December 31, 2019, the Company identified one municipal security that was deemed to be other-than-temporarily impaired. The security was issued by a tax incremental district in a municipality located in Wisconsin. During the year ended December 31, 2012, the Company received audited financial statements with respect to the municipal issuer that called into question the ability of the underlying taxing district that issued the securities to operate as a going concern. During the year ended December 31, 2012, the Company's analysis of the security in this municipality resulted in \$77,000 in credit losses that were charged to earnings with respect to this municipal security. An additional \$17,000 credit loss was charged to earnings during the year ended December 31, 2014 with respect to this security as a sale occurred at a discounted price. As of December 31, 2019, the remaining impaired security had an amortized cost of \$116,000 and a total life-to-date impairment of \$94,000.

As of December 31, 2019, the Company had one corporate debt security, included in other debt securities, seven mortgage-backed securities, and nine government sponsored enterprise issued securities which had been in an unrealized loss position for twelve months or longer. These securities were determined not to be other-than-temporarily impaired as of December 31, 2019. The Company has determined that the decline in fair value of these securities is not attributable to credit deterioration, and as the Company does not intend to sell nor is it more likely than not that it will be required to sell these securities before recovery of the amortized cost basis, these securities are not considered other-than-temporarily impaired.

The unrealized losses for the other debt security with an unrealized loss greater than 12 months is due to the current slope of the yield curve. The security earns a floating rate that is indexed to the 10 year Treasury interest rate. The Company does not intend to sell nor does it believe that it will be required to sell the security before recovery of their amortized cost basis.

### 3) Loans Receivable

Loans receivable at December 31, 2019 and 2018 are summarized as follows:

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Mortgage loans:		
Residential real estate:		
One- to four-family	\$ 480,280	489,979
Multi family	584,859	597,087
Home equity	18,071	19,956
Construction and land	37,033	13,361
Commercial real estate	236,703	225,522
Consumer	832	433
Commercial loans	30,253	32,810
Total loans receivable	<u>\$ 1,388,031</u>	<u>1,379,148</u>

The Company provides several types of loans to its customers, including residential, construction, commercial and consumer loans. Significant loan concentrations are considered to exist for a financial institution when there are amounts loaned to one borrower or to multiple borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. While credit risks tend to be geographically concentrated in the Company's Milwaukee metropolitan area and while 78.0% of the Company's loan portfolio involves loans that are secured by residential real estate, there are no concentrations with individual or groups of related borrowers. While the real estate collateralizing these loans is primarily residential in nature, it ranges from owner-occupied single family homes to large apartment complexes.

Qualifying loans receivable totaling \$1.07 billion and \$1.00 billion are pledged as collateral against \$470.0 million and \$430.0 million in outstanding Federal Home Loan Bank of Chicago advances under a blanket security agreement at both December 31, 2019 and December 31, 2018.

Certain of the Company's executive officers, directors, employees, and their related interests have loans with the Bank. As of December 31, 2019 and December 31, 2018, loans aggregating approximately \$6.3 million and \$5.3 million, respectively, were outstanding to such parties. None of these loans were past due or considered impaired as of December 31, 2019 and December 31, 2018.

An analysis of past due loans receivable as of December 31, 2019 and 2018 follows:

	As of December 31, 2019					
	1-59 Days Past Due (1)	60-89 Days Past Due (2)	Greater Than 90 Days	Total Past Due	Current (3)	Total Loans
Mortgage loans:	(In Thousands)					
Residential real estate:						
One- to four-family	\$ 1,179	638	3,969	5,786	474,494	480,280
Multi family	-	-	360	360	584,499	584,859
Home equity	-	10	-	10	18,061	18,071
Construction and land	-	-	-	-	37,033	37,033
Commercial real estate	-	-	303	303	236,400	236,703
Consumer	-	-	-	-	832	832
Commercial loans	6	-	-	6	30,247	30,253
Total	\$ 1,185	648	4,632	6,465	1,381,566	1,388,031

	As of December 31, 2018					
	1-59 Days Past Due (1)	60-89 Days Past Due (2)	Greater Than 90 Days	Total Past Due	Current (3)	Total Loans
Mortgage loans:	(In Thousands)					
Residential real estate:						
One- to four-family	\$ 1,523	76	3,834	5,433	484,546	489,979
Multi family	-	-	937	937	596,150	597,087
Home equity	216	42	111	369	19,587	19,956
Construction and land	-	-	-	-	13,361	13,361
Commercial real estate	39	-	125	164	225,358	225,522
Consumer	29	-	-	29	404	433
Commercial loans	-	-	18	18	32,792	32,810
Total	\$ 1,807	118	5,025	6,950	1,372,198	1,379,148

- (1) Includes \$53,000 and \$422,000 for December 31, 2019 and 2018, respectively, which are on non-accrual status.
- (2) Includes \$291,000 and \$118,000 for December 31, 2019 and 2018, respectively, which are on non-accrual status.
- (3) Includes \$2.0 million and \$990,000 for December 31, 2019 and 2018, respectively, which are on non-accrual status.

As of December 31, 2019 and 2018, there were no loans that were 90 or more days past due and still accruing interest.

A summary of the activity for the years ended 2019, 2018 and 2017 in the allowance for loan losses follows:

	<u>One- to Four- Family</u>	<u>Multi Family</u>	<u>Home Equity</u>	<u>Construction and Land</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Total</u>
	(In Thousands)							
Year ended December 31, 2019								
Balance at beginning of period	\$ 5,742	4,153	325	400	2,126	20	483	13,249
Provision (credit) for loan losses	(845)	(42)	(107)	210	(4)	(1)	(111)	(900)
Charge-offs	(125)	(3)	(44)	-	(2)	(5)	-	(179)
Recoveries	135	30	27	-	25	-	-	217
Balance at end of period	<u>\$ 4,907</u>	<u>4,138</u>	<u>201</u>	<u>610</u>	<u>2,145</u>	<u>14</u>	<u>372</u>	<u>12,387</u>
Year ended December 31, 2018								
Balance at beginning of period	\$ 5,794	4,431	356	949	1,881	10	656	14,077
Provision (credit) for loan losses	(142)	(353)	(56)	(589)	243	10	(173)	(1,060)
Charge-offs	(69)	(14)	(1)	-	-	-	-	(84)
Recoveries	159	89	26	40	2	-	-	316
Balance at end of period	<u>\$ 5,742</u>	<u>4,153</u>	<u>325</u>	<u>400</u>	<u>2,126</u>	<u>20</u>	<u>483</u>	<u>13,249</u>
Year ended December 31, 2017								
Balance at beginning of period	\$ 7,164	4,809	364	1,016	1,951	12	713	16,029
Provision (credit) for loan losses	(299)	(494)	(34)	(215)	(64)	(3)	(57)	(1,166)
Charge-offs	(1,364)	(92)	-	(14)	(7)	-	-	(1,477)
Recoveries	293	208	26	162	1	1	-	691
Balance at end of period	<u>\$ 5,794</u>	<u>4,431</u>	<u>356</u>	<u>949</u>	<u>1,881</u>	<u>10</u>	<u>656</u>	<u>14,077</u>

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of the year ended December 31, 2019 follows:

	<u>One- to Four- Family</u>	<u>Multi Family</u>	<u>Home Equity</u>	<u>Construction and Land</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Total</u>
	(In Thousands)							
Allowance related to loans individually evaluated for impairment	\$ 32	-	-	-	7	-	-	39
Allowance related to loans collectively evaluated for impairment	4,875	4,138	201	610	2,138	14	372	12,348
Balance at end of period	<u>\$ 4,907</u>	<u>4,138</u>	<u>201</u>	<u>610</u>	<u>2,145</u>	<u>14</u>	<u>372</u>	<u>12,387</u>
Loans individually evaluated for impairment	\$ 8,725	667	84	-	581	-	-	10,057
Loans collectively evaluated for impairment	471,555	584,192	17,987	37,033	236,122	832	30,253	1,377,974
Total gross loans	<u>\$ 480,280</u>	<u>584,859</u>	<u>18,071</u>	<u>37,033</u>	<u>236,703</u>	<u>832</u>	<u>30,253</u>	<u>1,388,031</u>

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of the year ended December 31, 2018 follows:

	<u>One- to Four- Family</u>	<u>Multi Family</u>	<u>Home Equity</u>	<u>Construction and Land</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Total</u>
(In Thousands)								
Allowance related to loans individually evaluated for impairment	\$ 73	-	46	-	67	-	-	186
Allowance related to loans collectively evaluated for impairment	5,669	4,153	279	400	2,059	20	483	13,063
Balance at end of period	<u>\$ 5,742</u>	<u>4,153</u>	<u>325</u>	<u>400</u>	<u>2,126</u>	<u>20</u>	<u>483</u>	<u>13,249</u>
Loans individually evaluated for impairment	\$ 7,642	1,309	246	-	2,885	-	18	12,100
Loans collectively evaluated for impairment	482,337	595,778	19,710	13,361	222,637	433	32,792	1,367,048
Total gross loans	<u>\$ 489,979</u>	<u>597,087</u>	<u>19,956</u>	<u>13,361</u>	<u>225,522</u>	<u>433</u>	<u>32,810</u>	<u>1,379,148</u>

The following table presents information relating to the Company's internal risk ratings of its loans receivable as of December 31, 2019 and 2018:

	<u>One- to Four- Family</u>	<u>Multi Family</u>	<u>Home Equity</u>	<u>Construction and Land</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Commercial</u>	<u>Total</u>
(In Thousands)								
At December 31, 2019								
Substandard	\$ 8,725	668	285	-	581	-	754	11,013
Watch	5,975	-	3	-	1,412	-	847	8,237
Pass	465,580	584,191	17,783	37,033	234,710	832	28,652	1,368,781
	<u>\$ 480,280</u>	<u>584,859</u>	<u>18,071</u>	<u>37,033</u>	<u>236,703</u>	<u>832</u>	<u>30,253</u>	<u>1,388,031</u>
At December 31, 2018								
Substandard	\$ 7,799	1,309	246	-	678	-	889	10,921
Watch	4,662	491	468	-	4,343	-	906	10,870
Pass	477,518	595,287	19,242	13,361	220,501	433	31,015	1,357,357
	<u>\$ 489,979</u>	<u>597,087</u>	<u>19,956</u>	<u>13,361</u>	<u>225,522</u>	<u>433</u>	<u>32,810</u>	<u>1,379,148</u>

Factors that are important to managing overall credit quality include sound loan underwriting and administration, systematic monitoring of existing loans and commitments, effective loan review on an ongoing basis, early identification of potential problems, an allowance for loan losses, and sound non-accrual and charge-off policies. Our underwriting policies require an officers' loan committee review and approval of all loans in excess of \$500,000. A member of the credit department, independent of the loan originator, performs a loan review for all loans. Our ability to manage credit risk depends in large part on our ability to properly identify and manage problem loans. To do so, we maintain a loan review system under which our credit management personnel review non-owner occupied one- to four-family, multi-family, construction and land, and commercial real estate that individually, or as part of an overall borrower relationship exceed \$1.0 million in potential exposure and review commercial loans that individually, or as part of an overall borrower relationship exceed \$200,000 in potential exposure. Loans meeting these criteria are reviewed on an annual basis, or more frequently, if the loan renewal is less than one year. With respect to this review process, management has determined that pass loans include loans that exhibit acceptable financial statements, cash flow and leverage. Watch loans have potential weaknesses that deserve management's attention, and if left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the credit. Substandard loans are considered inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged. These loans generally have a well-defined weakness that may jeopardize liquidation of the debt and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Finally, a loan is considered to be impaired when it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Management has determined that all non-accrual loans and loans modified under troubled debt restructurings meet the definition of an impaired loan.

The Company's procedures dictate that an updated valuation must be obtained with respect to underlying collateral at the time a loan is deemed impaired. Updated valuations may also be obtained upon transfer from loans receivable to real estate owned based upon the age of the prior appraisal, changes in market conditions or known changes to the physical condition of the property.

Estimated fair values are reduced to account for sales commissions, broker fees, unpaid property taxes and additional selling expenses to arrive at an estimated net realizable value. This estimated adjustment factor is based upon the Company's actual experience with respect to sales of real estate owned over the prior two years. In situations in which we are placing reliance on an appraisal that is more than one year old, an additional adjustment factor is applied to account for downward market pressure since the date of appraisal. The additional adjustment factor is based upon relevant sales data available for our general operating market as well as company-specific historical net realizable values as compared to the most recent appraisal prior to disposition.

With respect to over-four family income producing real estate, appraisals are reviewed and estimated collateral values are adjusted by updating significant appraisal assumptions to reflect current real estate market conditions. Significant assumptions reviewed and updated include the capitalization rate, rental income and operating expenses. These adjusted assumptions are based upon recent appraisals received on similar properties as well as on actual experience related to real estate owned and currently under Company management.

The following tables present data on impaired loans as of and for the year ended December 31, 2019 and 2018.

<b>As of or for the Year Ended December 31, 2019</b>						
	<b>Recorded Investment</b>	<b>Unpaid Principal</b>	<b>Reserve</b>	<b>Cumulative Charge-Offs</b>	<b>Average Recorded Investment</b>	<b>Interest Paid YTD</b>
<b>Total Impaired with Reserve</b>						
One- to four-family	\$ 217	217	32	-	221	15
Multi family	-	-	-	-	-	-
Home equity	-	-	-	-	-	-
Construction and land	-	-	-	-	-	-
Commercial real estate	7	416	7	409	10	-
Consumer	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
	<u>\$ 224</u>	<u>633</u>	<u>39</u>	<u>409</u>	<u>231</u>	<u>15</u>
<b>Total Impaired with no Reserve</b>						
One- to four-family	\$ 8,508	9,531	-	1,023	8,730	508
Multi family	667	1,491	-	824	705	78
Home equity	84	84	-	-	88	7
Construction and land	-	-	-	-	-	-
Commercial real estate	574	574	-	-	647	23
Consumer	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
	<u>\$ 9,833</u>	<u>11,680</u>	<u>-</u>	<u>1,847</u>	<u>10,170</u>	<u>616</u>
<b>Total Impaired</b>						
One- to four-family	\$ 8,725	9,748	32	1,023	8,951	523
Multi family	667	1,491	-	824	705	78
Home equity	84	84	-	-	88	7
Construction and land	-	-	-	-	-	-
Commercial real estate	581	990	7	409	657	23
Consumer	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
	<u>\$ 10,057</u>	<u>12,313</u>	<u>39</u>	<u>2,256</u>	<u>10,401</u>	<u>631</u>



## As of or for the Year Ended December 31, 2018

	<u>Recorded Investment</u>	<u>Unpaid Principal</u>	<u>Reserve</u>	<u>Cumulative Charge-Offs</u>	<u>Average Recorded Investment</u>	<u>Interest Paid YTD</u>
<b>Total Impaired with Reserve</b>						
One- to four-family	\$ 462	462	73	-	470	32
Multi family	-	-	-	-	-	-
Home equity	107	107	46	-	110	7
Construction and land	-	-	-	-	-	-
Commercial real estate	2,493	2,902	67	409	4,058	181
Consumer	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
	<u>\$ 3,062</u>	<u>3,471</u>	<u>186</u>	<u>409</u>	<u>4,638</u>	<u>220</u>
<b>Total Impaired with no Reserve</b>						
One- to four-family	\$ 7,180	8,120	-	940	7,355	383
Multi family	1,309	2,142	-	833	1,351	96
Home equity	139	139	-	-	144	5
Construction and land	-	-	-	-	-	-
Commercial real estate	392	392	-	-	431	15
Consumer	-	-	-	-	-	-
Commercial	18	18	-	-	25	-
	<u>\$ 9,038</u>	<u>10,811</u>	<u>-</u>	<u>1,773</u>	<u>9,306</u>	<u>499</u>
<b>Total Impaired</b>						
One- to four-family	\$ 7,642	8,582	73	940	7,825	415
Multi family	1,309	2,142	-	833	1,351	96
Home equity	246	246	46	-	254	12
Construction and land	-	-	-	-	-	-
Commercial real estate	2,885	3,294	67	409	4,489	196
Consumer	-	-	-	-	-	-
Commercial	18	18	-	-	25	-
	<u>\$ 12,100</u>	<u>14,282</u>	<u>186</u>	<u>2,182</u>	<u>13,944</u>	<u>719</u>

The difference between a loan's recorded investment and the unpaid principal balance represents a partial charge-off resulting from a confirmed loss due to the value of the collateral securing the loan being below the loan balance and management's assessment that the full collection of the loan balance is not likely.

When a loan is considered impaired, interest payments received are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

The determination as to whether an allowance is required with respect to impaired loans is based upon an analysis of the value of the underlying collateral and/or the borrower's intent and ability to make all principal and interest payments in accordance with contractual terms. The evaluation process is subject to the use of significant estimates and actual results could differ from estimates. This analysis is primarily based upon third party appraisals and/or a discounted cash flow analysis. In those cases in which no allowance has been provided for an impaired loan, the Company has determined that the estimated value of the underlying collateral exceeds the remaining outstanding balance of the loan. Of the total \$9.8 million of impaired loans as of December 31, 2019 for which no allowance has been provided, \$1.8 million in charge-offs have been recorded to reduce the unpaid principal balance to an amount that is commensurate with the loan's net realizable value, using the estimated fair value of the underlying collateral. To the extent that further deterioration in property values continues, the Company may have to reevaluate the sufficiency of the collateral servicing these impaired loans resulting in additional provisions to the allowance for loans losses or charge-offs.

The following presents data on troubled debt restructurings:

	As of December 31, 2019					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
One- to four-family	\$ 2,740	2	\$ 685	5	\$ 3,425	7
Multi family	-	-	308	2	308	2
Commercial real estate	278	1	7	1	285	2
	<u>\$ 3,018</u>	<u>3</u>	<u>\$ 1,000</u>	<u>8</u>	<u>\$ 4,018</u>	<u>11</u>

	As of December 31, 2018					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
	(Dollars in Thousands)					
One- to four-family	\$ 2,740	2	\$ 844	5	\$ 3,584	7
Multi family	-	-	372	2	372	2
Commercial real estate	2,759	2	17	1	2,776	3
	<u>\$ 5,499</u>	<u>4</u>	<u>\$ 1,233</u>	<u>8</u>	<u>\$ 6,732</u>	<u>12</u>

Troubled debt restructurings involve granting concessions to a borrower experiencing financial difficulty by modifying the terms of the loan in an effort to avoid foreclosure. Typical restructured terms include six months to twelve months months of principal forbearance, a reduction in interest rate or both. In no instances have the restructured terms included a reduction of outstanding principal balance. At December 31, 2019, \$4.0 million in loans had been modified in troubled debt restructurings and \$1.0 million of these loans were included in the non-accrual loan total. The remaining \$3.0 million, while meeting the internal requirements for modification in a troubled debt restructuring, were current with respect to payments under their original loan terms at the time of the restructuring, and thus continued to be included with accruing loans. Provided these loans perform in accordance with the modified terms, they will continue to be accounted for on an accrual basis.

All loans that have been modified in a troubled debt restructuring are considered to be impaired. As such, an analysis has been performed with respect to all of these loans to determine the need for a valuation reserve. When a loan is expected to perform in accordance with the restructured terms and ultimately return to and perform under contract terms, a valuation allowance is established equal to the excess of the present value of the expected future cash flows under the original contract terms as compared with the modified terms, including an estimated default rate. When there is doubt as to the borrower's ability to perform under the restructured terms or ultimately return to and perform under market terms, a valuation allowance is established equal to the impairment when the carrying amount exceeds fair value of the underlying collateral. As a result of the impairment analysis, a \$7,000 valuation allowance has been established as of December 31, 2019 with respect to the \$4.0 million in troubled debt restructurings. As of December 31, 2018, \$67,000 in valuation allowance had been established with respect to the \$6.7 million in troubled debt restructurings.

If an updated credit department review indicates no other evidence of elevated credit risk and the borrower completes a minimum of six consecutive contractual payments, the loan is returned to accrual status at that time.

The following presents troubled debt restructurings by concession type at December 31, 2019 and 2018:

	<b>As of December 31, 2019</b>					
	<b>Performing in accordance with modified terms</b>		<b>In Default</b>		<b>Total</b>	
	<b>Amount</b>	<b>Number</b>	<b>Amount</b>	<b>Number</b>	<b>Amount</b>	<b>Number</b>
	(Dollars in Thousands)					
Interest reduction and principal forbearance	\$ 3,246	6	448	2	3,694	8
Interest reduction	324	3	-	-	324	3
	<u>\$ 3,570</u>	<u>9</u>	<u>448</u>	<u>2</u>	<u>4,018</u>	<u>11</u>

	<b>As of December 31, 2018</b>					
	<b>Performing in accordance with modified terms</b>		<b>In Default</b>		<b>Total</b>	
	<b>Amount</b>	<b>Number</b>	<b>Amount</b>	<b>Number</b>	<b>Amount</b>	<b>Number</b>
	(Dollars in Thousands)					
Interest reduction and principal forbearance	\$ 5,848	7	546	2	6,394	9
Interest reduction	338	3	-	-	338	3
	<u>\$ 6,186</u>	<u>10</u>	<u>546</u>	<u>2</u>	<u>6,732</u>	<u>12</u>

The following presents data on troubled debt restructurings:

	<b>For the Year Ended</b>			
	<b>December 31, 2019</b>		<b>December 31, 2018</b>	
	<b>Amount</b>	<b>Number</b>	<b>Amount</b>	<b>Number</b>
	(Dollars in Thousands)			
Loans modified as a troubled debt restructure				
Commercial real estate	\$ -	-	2,476	1
	<u>\$ -</u>	<u>-</u>	<u>2,476</u>	<u>1</u>

There were no troubled debt restructurings within the past twelve months for which there was a default during the year ended December 31, 2019.

The following table presents data on non-accrual loans:

	<b>As of December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(Dollars in Thousands)	
Residential		
One- to four-family	\$ 5,985	4,902
Multi family	667	1,309
Home equity	70	201
Construction and land	-	-
Commercial real estate	303	125
Commercial	-	18
Consumer	-	-
Total non-accrual loans	<u>\$ 7,025</u>	<u>6,555</u>
Total non-accrual loans to total loans	0.51%	0.48%
Total non-accrual loans to total assets	0.35%	0.34%

#### 4) Office Properties and Equipment

Office properties and equipment are summarized as follows:

	December 31,	
	2019	2018
	(In Thousands)	
Land	\$ 7,516	7,357
Office buildings and improvements	34,433	32,473
Furniture and equipment	13,468	13,518
	55,417	53,348
Less accumulated depreciation	(30,389)	(28,824)
	<u>\$ 25,028</u>	<u>24,524</u>

Depreciation of premises and equipment totaled \$2.5 million, \$2.3 million and \$2.1 million for the years ended December 31, 2019, 2018 and 2017, respectively.

#### 5) Real Estate Owned

Real estate owned is summarized as follows:

	December 31,	
	2019	2018
	(In Thousands)	
One- to four-family	\$ 46	163
Multi-family	-	-
Construction and land	1,256	3,327
Commercial real estate	-	300
Total	<u>1,302</u>	<u>3,790</u>
Valuation allowance at end of period	(554)	(1,638)
Total real estate owned, net	<u>\$ 748</u>	<u>2,152</u>

The following table presents the activity in real estate owned:

	Year Ended December 31,	
	2019	2018
	(In Thousands)	
Real estate owned at beginning of period	\$ 2,152	4,558
Transferred in from loans receivable	1,052	545
Sales	(2,446)	(2,642)
Write downs	-	(309)
Other activity	(10)	-
Real estate owned at end of period	<u>\$ 748</u>	<u>2,152</u>

Residential one- to four-family mortgage loans that were in the process of foreclosure were \$2.3 million and \$2.2 million at December 31, 2019 and December 31, 2018, respectively.

## 6) Mortgage Servicing Rights

The following table presents the activity related to the Company's mortgage servicing rights:

	<b>Year ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Mortgage servicing rights at beginning of the period	\$ 109	\$ 888
Additions	354	427
Amortization	(104)	(191)
Sales	-	(1,015)
Mortgage servicing rights at end of the period	359	109
Valuation allowance at end of period	(77)	-
Mortgage servicing rights at the end of the period, net	<u>\$ 282</u>	<u>\$ 109</u>

During the year ended December 31, 2019, on a consolidated basis, \$2.85 billion in residential loans were originated for sale, which excludes the loans originated from Waterstone Mortgage Corporation and purchased by WaterStone Bank. During the same period, sales of loans held for sale totaled \$2.77 billion, generating mortgage banking income of \$125.7 million. The unpaid principal balance of loans serviced for others was \$64.9 million and \$14.1 million at December 31, 2019 and December 31, 2018 respectively. Loans serviced for others are not reflected in the consolidated statements of financial condition.

The fair value of mortgage servicing rights were \$282,000 at December 31, 2019 and \$109,000 at December 31, 2018.

During the year ended December 31, 2019, the Company did not sell any mortgage servicing rights. During the year ended December 31, 2018, the Company sold mortgage servicing rights related to \$148.7 million in loans receivable and with a book value of \$1.0 million for \$1.4 million resulting in a gain on sale of \$417,000.

The following table shows the estimated future amortization expense for mortgage servicing rights at December 31, 2019 for the years ended December 31 periods indicated:

	<b>(In Thousands)</b>
2020	\$ 63
2021	55
2022	47
2023	39
2024	31
Thereafter	47
Total	<u>\$ 282</u>

## 7) Deposits

The aggregate amount of time deposit accounts with balances greater than \$250,000 at December 31, 2019 and 2018 amounted to \$70.6 million and \$60.1 million, respectively.

A summary of interest expense on deposits is as follows:

	Years ended December 31,		
	2019	2018	2017
		(In Thousands)	
Interest-bearing demand deposits	\$ 33	33	28
Money market, savings, and escrow deposits	1,247	599	401
Time deposits	15,998	10,995	7,310
	<u>\$ 17,278</u>	<u>11,627</u>	<u>7,739</u>

A summary of the contractual maturities of time deposits at December 31, 2019 is as follows:

	(In Thousands)
Within one year	\$ 665,703
One to two years	70,049
Two to three years	2,352
Three to four years	871
Four through five years	796
	<u>\$ 739,771</u>

## 8) Borrowings

Borrowings consist of the following:

	December 31, 2019		December 31, 2018	
	Balance	Weighted Average Rate	Balance	Weighted Average Rate
(Dollars in Thousands)				
Short term:				
Repurchase agreements	\$ 13,562	4.66%	\$ 5,046	5.39%
Long term:				
Federal Home Loan Bank advances maturing:				
2027	50,000	1.73%	175,000	1.38%
2028	255,000	2.37%	255,000	2.37%
2029	165,000	1.61%	-	-
	<u>\$ 483,562</u>	2.11%	<u>\$ 435,046</u>	2.01%

The short-term repurchase agreements represents the outstanding portion of a total \$35.0 million commitment with one unrelated bank. The short-term repurchase agreement is utilized by Waterstone Mortgage Corporation to finance loans originated for sale. This agreement is secured by the underlying loans being financed. Related interest rates are based upon the note rate associated with the loans being financed. The short-term repurchase agreement had a \$13.6 million balance on a total commitment of \$35.0 million at December 31, 2019.

The Company enters into agreements under which it sells loans held for sale subject to an obligation to repurchase the same loans. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of assets. The obligation to repurchase the assets is reflected as a liability in the Company's consolidated statements of condition, while the loans held for sale underlying the repurchase agreements remain in loans held for sale as an asset in the Company's consolidated statements of condition. In other words, there is no offsetting or netting of the loans held for sale assets with the repurchase agreement liabilities. The Company's repurchase agreements are subject to master netting agreements, which sets forth the rights and obligations for repurchase and offset. Under the master netting agreement, the Company is entitled to set off the collateral placed with a single counterparty against obligations owed to that counterparty.

The \$50.0 million in advances due in 2027 has a fixed rate of 1.73% and has a contractual maturity date in December 2027.

The \$255.0 million in advances due in 2028 consists of one \$25.0 million advance with a fixed rate of 2.16% with a FHLB single call option in March 2020, two advances totaling \$55.0 million with a fixed rate of 2.27% and with a FHLB single call option in March 2021, one advance of \$25.0 million with a fixed rate of 2.40% and with a FHLB single call option in May 2020, two advances totaling \$50.0 million with fixed rates of 2.34% and 2.48% and with a FHLB single call option in May 2021, one advance of \$50.0 million with a fixed rate of 2.34% and with a FHLB quarterly call option beginning in June 2020, and one advance of \$50.0 million with a fixed rate of 2.57% and with a FHLB quarterly call option beginning in September 2020.

The \$165.0 million in advances due in 2029 consists of one \$50.0 million advance with a fixed rate of 1.98% with a FHLB quarterly call option in May 2022, one \$50.0 million advance with a fixed rate of 1.75% with a FHLB quarterly call option in August 2021, one \$25.0 million advance with a fixed rate of 1.52% with a FHLB quarterly call option in November 2020, and one advance of \$40.0 million with a fixed rate of 1.02% and with a FHLB quarterly call option.

The Company selects loans that meet underwriting criteria established by the Federal Home Loan Bank Chicago (FHLBC) as collateral for outstanding advances. The Company's borrowings at the FHLBC are limited to 80% of the carrying value of unencumbered one- to four-family mortgage loans, 64% of the carrying value of home equity loans and 75% of the carrying value of over four-family loans. In addition, these advances are collateralized by FHLBC stock of \$21.2 million at December 31, 2019 and \$19.4 million at December 31, 2018. In the event of prepayment, the Company is obligated to pay all remaining contractual interest on the advance.

## 9) Regulatory Capital

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements, or overall financial performance deemed by the regulators to be inadequate, can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and Bank's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Company's and Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Federal Reserve Board and the FDIC issued final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The final rules revised the regulatory capital elements, added a new common equity Tier I capital ratio, increased the minimum Tier 1 capital ratio requirements and implemented a new capital conservation buffer. The rules also permitted certain banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income. The Company and the Bank have made the election to retain the existing treatment for accumulated other comprehensive income. The final rules took effect for the Company and the Bank on January 1, 2015, subject to a transition period for certain parts of the rules.

In addition, as a result of the legislation, the federal banking agencies are required to develop a "Community Bank Leverage Ratio" (the ratio of a bank's tangible equity capital to average total consolidated assets) for financial institutions with assets of less than \$10 billion. A "qualifying community bank" that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered "well capitalized" under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution's risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement. On September 17, 2019, the Board of the Federal Deposit Insurance Corporation passed a final rule on the community bank leverage ratio, setting the minimum required community bank leverage ratio at 9%. In addition, the Federal Reserve Board was required to raise the asset threshold under its Small Bank Holding Company Policy Statement from \$1 billion to \$3 billion for bank or savings and loan holding companies that are exempt from consolidated capital requirements, provided that such companies meet certain other conditions such as not engaging in significant non-banking activities. The rule went into effect on January 1, 2020. A financial institution can elect to be subject to this new definition.

The table below includes the regulatory capital ratio requirements that became effective on January 1, 2015. Beginning in 2016, an additional capital conservation buffer was added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer was fully phased-in as of January 1, 2019 at 2.5%. A banking organization with a conservation buffer of less than 2.5% will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. At December 31, 2019, the ratios for the Company and the Bank are sufficient to meet the fully phased-in conservation buffer.



The actual and required capital amounts and ratios as of December 31, 2019 and 2018 are presented in the table below:

	<b>December 31, 2019</b>							
	<b>Actual</b>		<b>For Capital Adequacy Purposes</b>		<b>Minimum Capital Adequacy with Capital Buffer</b>		<b>To Be Well-Capitalized Under Prompt Corrective Action Provisions</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
	(Dollars In Thousands)							
<b>Total capital (to risk-weighted assets)</b>								
Consolidated Waterstone Financial , Inc.	\$ 404,748	26.17%	123,731	8.00%	162,398	10.500%	N/A	N/A
WaterStone Bank	353,357	22.85%	123,716	8.00%	162,378	10.500%	154,646	10.00%
<b>Tier I capital (to risk-weighted assets)</b>								
Consolidated Waterstone Financial , Inc.	392,361	25.37%	92,799	6.00%	131,465	8.500%	N/A	N/A
WaterStone Bank	340,970	22.05%	92,787	6.00%	131,449	8.500%	123,716	8.00%
<b>Common Equity Tier 1 Capital (to risk-weighted assets)</b>								
Consolidated Waterstone Financial , Inc.	392,361	25.37%	69,599	4.50%	108,265	7.000%	N/A	N/A
WaterStone Bank	340,970	22.05%	69,590	4.50%	108,252	7.000%	100,520	6.50%
<b>Tier I capital (to average assets)</b>								
Consolidated Waterstone Financial , Inc.	392,361	19.69%	79,691	4.00%	N/A	N/A	N/A	N/A
WaterStone Bank	340,970	17.11%	79,691	4.00%	N/A	N/A	99,614	5.00%
<b>State of Wisconsin (to total assets)</b>								
WaterStone Bank	340,970	17.11%	119,590	6.00%	N/A	N/A	N/A	N/A
<b>December 31, 2018</b>								
(Dollars In Thousands)								
<b>Total capital (to risk-weighted assets)</b>								
Consolidated Waterstone Financial , Inc.	\$ 414,566	28.22%	117,506	8.00%	145,046	9.88%	N/A	N/A
WaterStone Bank	395,783	26.95%	117,490	8.00%	145,027	9.88%	146,863	10.00%
<b>Tier I capital (to risk-weighted assets)</b>								
Consolidated Waterstone Financial , Inc.	401,317	27.32%	88,130	6.00%	115,670	7.88%	N/A	N/A
WaterStone Bank	382,534	26.05%	88,118	6.00%	115,655	7.88%	117,490	8.00%
<b>Common Equity Tier 1 Capital (to risk-weighted assets)</b>								
Consolidated Waterstone Financial , Inc.	401,317	27.32%	66,097	4.50%	93,638	6.38%	N/A	N/A
WaterStone Bank	382,534	26.05%	66,088	4.50%	93,625	6.38%	95,461	6.50%
<b>Tier I capital (to average assets)</b>								
Consolidated Waterstone Financial , Inc.	401,317	21.06%	76,214	4.00%	N/A	N/A	N/A	N/A
WaterStone Bank	382,534	20.08%	76,214	4.00%	N/A	N/A	95,268	5.00%
<b>State of Wisconsin (to total assets)</b>								
WaterStone Bank	382,534	20.01%	114,712	6.00%	N/A	N/A	N/A	N/A

## 10) Stock Based Compensation

### Stock-Based Compensation Plan

In 2006, the Company's shareholders approved the 2006 Equity Incentive Plan. All stock awards granted under this plan vest over a period of five years and are required to be settled in shares of the Company's common stock. The exercise price for all stock options granted is equal to the quoted NASDAQ market closing price on the date that the awards were granted and expire ten years after the grant date, if not exercised. All restricted stock grants are issued from previously unissued shares.

In 2015, the Company's shareholders approved the 2015 Equity Incentive Plan. A total of 2,530,000 stock options and 1,012,000 restricted shares were approved for award. A total of 1,302,000 stock options and 466,000 restricted stock are available to be issued as of December 31, 2019. The stock options granted to employees under this plan typically vest over a period of five years. The stock option awards granted to directors under this plan vest over a period of eight years. The exercise price for all stock options granted is equal to the quoted NASDAQ market close price on the date that the awards were granted and expire ten years after the grant date, if not exercised. The restricted stock awards granted to employees under this plan vest in five installments over four years with one installment vesting immediately. The stock awards granted to directors under this plan vest in eight installments over seven years with one installment vesting immediately. The fair value of the restricted stock awards were equal to the quoted NASDAQ market closing price on the vest date.

### Accounting for Stock-Based Compensation Plan

The fair value of stock options granted is estimated on the grant date using a Black-Scholes pricing model. The fair value of restricted shares is equal to the quoted NASDAQ market closing price on the date of grant. The fair value of stock grants is recognized as compensation expense on a straight-line basis over the vesting period of the grants. Compensation expense is included in compensation, payroll taxes and other employee benefits in the consolidated statements of income.

Assumptions are used in estimating the fair value of stock options granted. The weighted average expected life of the stock options represent the period of time that the options are expected to be outstanding and is based on the historical results from the previous awards. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected volatility is based on the actual volatility of Waterstone Financial, Inc. stock for the weighted average life time period prior to issuance date. The following assumptions were used in estimating the fair value of options granted in the years ended December 31, 2019 and 2018.

	2019		2018	
	Minimum	Maximum	Minimum	Maximum
Dividend yield	2.56%	2.92%	2.70%	2.74%
Risk-free interest rate	1.42%	2.28%	2.57%	2.96%
Expected volatility	16.07%	16.37%	16.27%	30.88%
Weighted average expected life	5.0	5.8	5.4	6.2
Weighted average per share value of options	\$ 1.72	2.12	1.97	4.26

The Company's policy is to adjust compensation expense at the time of actual stock grant forfeiture.

A summary of the Company's stock option activity for the years ended December 31, 2019, 2018 and 2017 is presented below.

<b>Stock Options</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Years Remaining in Contractual Term</b>	<b>Aggregate Intrinsic Value (000's)</b>
Outstanding December 31, 2016	1,362,499	\$ 11.83	7.74	8,785
Options exercisable at December 31, 2016	304,595	9.66	6.44	2,625
Granted	20,000	18.78		(35)
Exercised	(211,205)	6.48		2,233
Forfeited	(12,195)	14.83		27
Outstanding December 31, 2017	1,159,099	12.89	7.24	4,870
Options exercisable at December 31, 2017	331,097	12.53	7.10	1,501
Granted	80,000	17.23		3
Exercised	(106,030)	12.30		473
Forfeited	(72,000)	13.97		224
Outstanding December 31, 2018	1,061,069	13.21	6.47	3,850
Options exercisable at December 31, 2018	421,068	12.78	6.23	1,688
Granted	30,000	17.13		56
Exercised	(50,298)	13.10		298
Forfeited	(15,000)	15.62		51
Outstanding December 31, 2019	1,025,771	13.29	5.56	5,887
Options exercisable at December 31, 2019	546,770	12.93	5.31	3,335

The following table summarizes information about the Company's stock options outstanding at December 31, 2019.

<b>Range of Exercise Prices</b>	<b>Options Outstanding</b>	<b>Weighted Average Exercise Price</b>	<b>Remaining Life (Years)</b>	<b>Options Exercisable</b>	<b>Weighted Average Exercise Price</b>	<b>Remaining Life (Years)</b>
\$ 0.01 - \$5.00	4,233	\$ 1.73	2.01	4,233	\$ 1.73	2.01
\$ 5.01 - \$10.00	-	-	-	-	-	-
\$ 10.01 - \$15.00	903,538	12.81	5.21	517,537	12.82	5.22
Over \$15.01	118,000	17.55	8.36	25,000	17.84	7.75
	<u>1,025,771</u>	<u>\$ 13.29</u>	<u>5.56</u>	<u>546,770</u>	<u>\$ 12.93</u>	<u>5.31</u>

The following table summarizes information about the Company's nonvested stock option activity for the years ended December 31, 2019 and 2018:

<b>Stock Options</b>	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Nonvested at December 31, 2017	828,002	\$ 3.27
Granted	80,000	3.66
Vested	(200,001)	3.27
Forfeited	(68,000)	3.46
Nonvested at December 31, 2018	<u>640,001</u>	3.30
Nonvested at December 31, 2018	640,001	3.30
Granted	30,000	1.87
Vested	(176,000)	3.28
Forfeited	(15,000)	2.34
Nonvested at December 31, 2019	<u>479,001</u>	3.24

The Company amortizes the expense related to stock options as compensation expense over the vesting period. Expense for the stock options granted of \$582,000, \$608,000 and \$638,000 was recognized during the years ended December 31, 2019, 2018 and 2017, respectively. At December 31, 2019, the Company had \$1.1 million in estimated unrecognized compensation costs related to outstanding stock options that is expected to be recognized over a weighted average period of 24 months.

The following table summarizes information about the Company's restricted stock shares activity for the years ended December 31, 2019 and 2018:

<b>Restricted Stock</b>	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Nonvested at December 31, 2017	259,200	\$ 12.85
Granted	-	-
Vested	(93,100)	12.84
Forfeited	(3,500)	12.75
Nonvested at December 31, 2018	<u>162,600</u>	12.85
Nonvested at December 31, 2018	162,600	12.85
Granted	-	-
Vested	(89,600)	12.84
Forfeited	-	-
Nonvested at December 31, 2019	<u>73,000</u>	12.86

The Company amortizes the expense related to restricted stock awards as compensation expense over the vesting period. Expense for the restricted stock awards of \$486,000, \$1.2 million and \$1.3 million was recorded for the years ended December 31, 2019, 2018 and 2017, respectively. At December 31, 2019, the Company had \$660,000 of unrecognized compensation expense related to restricted stock shares that is expected to be recognized over a weighted average period of 25 months.

## 11) Employee Benefit Plans

The Company has two 401(k) profit sharing plans and trusts covering substantially all employees. WaterStone Bank employees over 18 years of age are immediately eligible to participate in the Bank's plan. Waterstone Mortgage employees over 18 years of age are eligible to participate in its plan as of the first of the month following their date of employment. Participating employees may annually contribute pretax compensation in accordance with IRS limits. The Company made matching contributions of \$1.0 million, \$971,000 and \$825,000 to the plans during the years ended December 31, 2019, 2018 and 2017 respectively.

## 12) Employee Stock Ownership Plan

All employees are eligible to participate in the WaterStone Bank Employee Stock Ownership Plan (the "Plan") after they attain 21 years of age and complete 12 consecutive months of service in which they work at least 1,000 hours of service. The Plan debt is secured by shares of the Company. The Company has committed to make annual contributions to the Plan necessary to repay the loan, including interest.

During the year ended December 31, 2005, the Plan borrowed \$8.5 million from the Company and purchased 835,610 shares of common stock of the Company in the open market. During the year ended December 31, 2014, the Plan borrowed an additional \$23.8 million from the Company, refinanced the remaining 83,561 shares (related to the 2005 Plan purchase), and purchased an additional 2,024,000 shares of common stock of the Company in the open market. While the shares are not released and allocated to Plan participants until the loan payment is made, the shares are deemed to be earned and are therefore, committed to be released throughout the service period. As such, one-twentieth of the total 2,107,561 shares are scheduled to be released annually as shares are earned over a period of 20 years, beginning with the period ended December 31, 2014. As the debt is repaid, shares are released from collateral and allocated to active participant accounts. The shares pledged as collateral are reported as "Unearned ESOP shares" in the consolidated statement of financial condition. As shares are committed to be released from collateral, the Company reports compensation expense equal to the average fair market price of the shares, and the shares become outstanding for earnings per share computations. Compensation expense attributed to the ESOP was \$1.8 million, \$1.8 million and \$2.0 million, respectively for the years ended December 31, 2019, 2018 and 2017.

The aggregate activity in the number of unearned ESOP shares, considering the allocation of those shares committed to be released as of December 31, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Beginning ESOP shares	1,580,671	1,686,049
Shares committed to be released	(105,378)	(105,378)
Unreleased shares	<u>1,475,293</u>	<u>1,580,671</u>
Fair value of unreleased shares (in millions)	\$ 28.1	26.5

## 13) Income Taxes

The provision for income taxes for the year ended December 31, 2019, 2018 and 2017 consists of the following:

	<u>Years ended December 31,</u>		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In Thousands)		
Current:			
Federal	\$ 8,377	7,087	13,028
State	2,655	1,904	2,362
	<u>11,032</u>	<u>8,991</u>	<u>15,390</u>
Deferred:			
Federal	619	452	2,960
State	20	83	119
	<u>639</u>	<u>535</u>	<u>3,079</u>
Total	<u>\$ 11,671</u>	<u>9,526</u>	<u>18,469</u>

The income tax provisions differ from that computed at the Federal statutory corporate tax rate for the years ended December 31, 2019, 2018 and 2017 as follows:

	<b>Years ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
	(Dollars In Thousands)		
Income before income taxes	\$ 47,574	40,280	44,433
Tax at Federal statutory rate (21% in 2019 and 2018, 35% in 2017)	9,991	8,459	15,552
Add (deduct) effect of:			
State income taxes net of Federal income tax benefit	2,113	1,570	1,613
Cash surrender value of life insurance	(406)	(388)	(632)
Non-deductible ESOP and stock option expense	186	188	380
Tax-exempt interest income	(236)	(248)	(449)
Non-deductible compensation	216	177	280
Deferred tax asset revaluation	-	-	2,644
Stock compensation	(146)	(160)	(1,074)
Other	(47)	(72)	155
Income tax provision	<u>11,671</u>	<u>9,526</u>	<u>18,469</u>
Effective tax rate	24.5%	23.6%	41.6%

The significant components of the Company's net deferred tax assets (liabilities) included in prepaid expenses and other assets are as follows at December 31, 2019 and 2018:

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Gross deferred tax assets:		
Restricted stock and stock options	440	526
Allowance for loan losses	3,031	3,239
Repurchase reserve for loans sold	244	139
Non-accrual interest	262	292
Real estate owned	305	741
Capital loss carryforward	-	23
Unrealized loss on impaired securities	23	23
Unrealized loss on securities available for sale, net	-	695
Lease liability	2,170	-
Other	32	98
Total gross deferred tax assets	<u>6,507</u>	<u>5,776</u>
Gross deferred tax liabilities:		
Excess tax depreciation	(80)	(28)
Unrealized gain on securities available for sale, net	(429)	-
Mortgage servicing rights	(75)	(29)
FHLB stock dividends	(51)	(68)
Lease asset	(2,053)	-
Deferred loan fees	(406)	(475)
Deferred liabilities	<u>(3,094)</u>	<u>(600)</u>
Net deferred tax assets	<u>\$ 3,413</u>	<u>5,176</u>

The Company had a Wisconsin net operating loss carry forward of \$22,000 at December 31, 2019 which will begin to expire in 2028. The Company has no capital loss carryforwards as of December 31, 2019.

Under the Internal Revenue Code and Wisconsin Statutes, the Company was permitted to deduct, for tax years beginning before 1988, an annual addition to a reserve for bad debts. This amount differs from the provision for loan losses recorded for financial accounting purposes. Under prior law, bad debt deductions for income tax purposes were included in taxable income of later years only if the bad debt reserves were used for purposes other than to absorb bad debt losses. Because the Company did not intend to use the reserve for purposes other than to absorb losses, no deferred income taxes were provided. Retained earnings at December 31, 2019 include approximately \$16.7 million for which no deferred Federal or state income taxes were provided. Deferred income taxes have been provided on certain additions to the tax reserve for bad debts.

The Company and its subsidiaries file consolidated federal and combined state tax returns. One subsidiary also files separate state income tax returns in certain states. The Company is no longer subject to state income tax examinations by certain state tax authorities for years before 2015 or subject to federal tax examinations for the years before 2016.

#### 14) Commitments, Off-Balance Sheet Arrangements, and Contingent Liabilities

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Financial instruments whose contract amounts represent potential credit risk:		
Commitments to extend credit under first mortgage loans <sup>(1)</sup>	\$ 13,389	33,762
Commitments to extend credit under home equity lines of credit	13,776	14,903
Unused portion of construction loans	90,439	79,776
Unused portion of business lines of credit	14,623	16,778
Standby letters of credit	885	860

(1) Excludes commitments to originate loans held for sale, which are discussed in Footnote 15 - Derivative Financial Instruments.

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 clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements of the Company. 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 counter-party. Collateral obtained generally consists of mortgages on the underlying real estate.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds mortgages on the underlying real estate as collateral supporting those commitments for which collateral is deemed necessary.

The Company has determined that there are no probable losses related to commitments to extend credit or the standby letters of credit as of December 31, 2019 and 2018.

In the normal course of business, the Company, or its subsidiaries are involved in various legal proceedings. In the opinion of management, any liability resulting from pending proceedings would not be expected to have a material adverse effect on the Company's consolidated financial statements.

##### *Herrington et al. v. Waterstone Mortgage Corporation*

Waterstone Mortgage Corporation was a defendant in a class action lawsuit that was filed in the United States District Court for the Western District of Wisconsin and subsequently compelled to arbitration before the American Arbitration Association. The plaintiff class alleged that Waterstone Mortgage Corporation violated certain provisions of the Fair Labor Standards Act (FLSA) and failed to pay loan officers consistent with their employment agreements. On July 5, 2017, the arbitrator issued a Final Award finding Waterstone Mortgage Corporation liable for unpaid minimum wages, overtime, unreimbursed business expenses, and liquidated damages under the FLSA. On December 8, 2017, the District Court confirmed the award in large part, and entered a judgment against Waterstone in the amount of \$7,267,919 in damages to Claimants, \$3,298,851 in attorney fees and costs, and a \$20,000 incentive fee to Plaintiff Herrington. The judgment was appealed by Waterstone to the Seventh Circuit Court of Appeals, where oral argument was held on May 29, 2018. On October 22, 2018, the Seventh Circuit issued a ruling vacating the District Court's order enforcing the arbitration award. It found that Plaintiff Herrington had an enforceable class action waiver in her arbitration agreement, and remanded the case to the District Court. On April 25, 2019, the District Court held that Plaintiff's claims must be resolved through single-plaintiff arbitration. As a result, it vacated the July 5, 2017 arbitration award in its entirety, and issued a revised judgement in Waterstone's favor.

In May 2019, Herrington re-initiated her individual arbitration. Over Waterstone's objection, the arbitrator considered evidence from the prior vacated proceeding. A hearing was held in Herrington's individual arbitration in November 2019, and Herrington sought over \$55,000 in damages on her individual claim, plus punitive damages, attorney fees and costs. The arbitrator issued a written award on February 18, 2020 and in which he found Waterstone liable for damages. Herrington has requested damages of \$15,000. The arbitrator has not yet awarded a damages figure. The arbitrator also has not yet ruled on the issue of attorney fees.

Waterstone disagrees with the ruling and will vigorously pursue all available challenges to it. Waterstone still retains the right to challenge the award in Court, through a motion to vacate or modify the award. Even if the award is confirmed and a judgment is entered, it retains its appellate rights to challenge the award before the Seventh Circuit. Waterstone believes there are meaningful avenues for appeal, including challenging the arbitrator's reliance on prior findings from a vacated proceeding. Given these recent developments, Waterstone does not believe a loss is probable at this time, as that term is used in assessing loss contingencies. Accordingly, in accordance with the authoritative guidance in the evaluation of contingencies, the Company has not recorded an accrual related to this matter. However, given the award, a loss is reasonably possible and Waterstone would not characterize the chance of any loss as "remote." If the arbitrator's award is confirmed, we estimate that Herrington would recover approximately \$15,000 in damages. The Company cannot reasonably estimate the amount of fees Herrington will seek or that will be awarded at this time.

#### *Various Claimants v. Waterstone Mortgage Corporation*

Waterstone Mortgage Corporation was a defendant in a class action lawsuit that was filed in the United States District Court for the Western District of Wisconsin and subsequently compelled to arbitration before the American Arbitration Association. The plaintiff class alleged that Waterstone Mortgage Corporation violated certain provisions of the Fair Labor Standards Act (FLSA) and failed to pay loan officers consistent with their employment agreements. On July 5, 2017, the arbitrator issued a Final Award finding Waterstone Mortgage Corporation liable for unpaid minimum wages, overtime, unreimbursed business expenses, and liquidated damages under the FLSA. On December 8, 2017, the District Court entered a judgment against Waterstone in the amount of \$7,267,919 in damages to Claimants, \$3,298,851 in attorney fees and costs, and a \$20,000 incentive fee to Plaintiff Herrington.

The judgment was then appealed by Waterstone to the Seventh Circuit Court of Appeals. On October 22, 2018, the Seventh Circuit issued a ruling vacating the District Court's order enforcing the arbitration award. It found that Plaintiff Herrington had an enforceable class action waiver in her arbitration agreement, and remanded the case to the District Court. On April 25, 2019, the District Court held that Plaintiff Herrington's claims must be resolved through single-plaintiff arbitration. As a result, it vacated the July 5, 2017 arbitration award in its entirety, and issued a revised judgment in Waterstone's favor.

In May 2019, approximately 89 of the prior claimants in the aforementioned class action lawsuit filed new demands in arbitration asserting similar claims ("the Arbitrations"). For the other claimants, Waterstone has answered those demands and denies the allegations, and Waterstone will continue to vigorously defend its interests in these matters. Waterstone does not believe a loss is probable at this time, as that term is used in assessing loss contingencies. Accordingly, in accordance with the authoritative guidance in the evaluation of contingencies, the Company has not recorded an accrual related to this matter. However, an unfavorable outcome is reasonably possible and Waterstone would not characterize the chance of any loss as "remote." Given the early stage of the numerous proceedings, Waterstone cannot yet offer an opinion on the estimated range of any possible loss, in the event of an unfavorable opinion.



## 15) Derivative Financial Instruments

In connection with its mortgage banking activities, the Company enters into derivative financial instruments as part of its strategy to manage its exposure to changes in interest rates. Mortgage banking derivatives include interest rate lock commitments provided to customers to fund mortgage loans to be sold in the secondary market and forward commitments for the future delivery of such loans. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of future changes in interest rates on its commitments to fund the loans as well as on its portfolio of mortgage loans held-for-sale. The Company's mortgage banking derivatives have not been designated as being a hedge relationship. These instruments are used to manage the Company's exposure to interest rate movements and other identified risks but do not meet the strict hedge accounting requirements of ASC 815. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in earnings. The Company does not use derivatives for speculative purposes.

Forward commitments to sell mortgage loans represent commitments obtained by the Company from a secondary market agency to purchase mortgages from the Company at specified interest rates and within specified periods of time. Commitments to sell loans are made to mitigate interest rate risk on interest rate lock commitments to originate loans and loans held for sale. At December 31, 2019, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of \$345.0 million and interest rate lock commitments with an aggregate notional amount of approximately \$174.3 million. The fair value of the forward commitments to sell mortgage loans at December 31, 2019 included a gain of \$3,000 that is reported as a component of other assets on the Company's consolidated statement of financial condition. The fair value of the interest rate locks at December 31, 2019 included a gain of \$1.8 million that is reported as a component of other assets on the Company's consolidated statements of financial condition. At December 31, 2018, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of \$276.3 million and interest rate lock commitments with an aggregate notional amount of approximately \$164.9 million. The fair value of the forward commitments to sell mortgage loans at December 31, 2018 included a loss of \$1.1 million that is reported as a component of other liabilities on the Company's consolidated statement of financial condition. The fair value of the interest rate locks at December 31, 2018 included a gain of \$2.0 million that is reported as a component of other assets on the Company's consolidated statements of financial condition.

In determining the fair value of its derivative loan commitments, the Company considers the value that would be generated when the loan arising from exercise of the loan commitment is sold in the secondary mortgage market. That value includes the price that the loan is expected to be sold for in the secondary mortgage market. The fair value of these commitments is recorded on the consolidated statements of financial condition with the changes in fair value recorded as a component of mortgage banking income.

Residential mortgage loans sold to others are predominantly conventional residential first lien mortgages. The Company's agreements to sell residential mortgage loans in the normal course of business usually require certain representations and warranties on the underlying loans sold related to credit information, loan documentation and collateral, which if subsequently are untrue or breached, could require the Company to repurchase certain loans affected. The Company has only been required to make insignificant repurchases as a result of breaches of representations and warranties. The Company's agreements to sell residential mortgage loans also contain limited recourse provisions. The recourse provisions are limited in that the recourse provision ends after certain payment criteria have been met. With respect to these loans, repurchase or a return of servicing release premium could be required if defined delinquency issues or an early payoff occurred during the limited recourse period.

The Company may offer derivative contracts to its customers in connection with their risk management needs. The Company manages the risk associated with these contracts by entering into an equal and offsetting derivative with a third-party dealer. These derivatives generally work together as an economic interest rate hedge, but the Company does not designate them for hedge accounting treatment. Consequently, changes in fair value of the corresponding derivative financial asset or liability are recorded as either a charge or credit to current earnings during the period in which the changes occurred. The fair value of the swaps is recorded as both an asset and a liability, in other assets and other liabilities on the Company's consolidated statement of financial condition, respectively, in equal amounts for these transactions.

At December 31, 2019, the aggregate amortizing notional value of interest rate swaps with various commercial borrowers was \$30.9 million. The Company receives fixed rates and pays floating rates based upon LIBOR on the swaps with commercial borrowers. These interest rate swaps mature in December 2029. Commercial borrower swaps are completed independently with each borrower and are not subject to master netting arrangements. These commercial borrower swaps were reported as a component of other assets on the Company's consolidated statement of financial condition of \$680,000. As of December 31, 2019, no interest rate swaps were in default.

At December 31, 2019, the aggregate amortizing notional value of interest rate swaps with dealer counterparties was also \$30.9 million. The Company pays fixed rates and receives floating rates based upon LIBOR on the swaps with dealer counterparties. These interest rate swaps mature in December 2029. Dealer counterparty swaps are subject to master netting agreements among the contracts within our Bank and are reported as a component of other liabilities on the Company's consolidated statement of financial condition of \$680,000. No right of offset existed with dealer counterparty swaps as of December 31, 2019.

All changes in the fair value of these instruments are recorded in other non-interest income. The Company pledged \$710,000 in cash to secure its obligation under these contracts at December 31, 2019.

There were no loan interest rate swaps as of December 31, 2018.

## 16) Fair Value Measurements

ASC Topic 820, "Fair Value Measurements and Disclosures" defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This accounting standard applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements. The standard also emphasizes that fair value (i.e., the price that would be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date), among other things, is based on exit price versus entry price, should include assumptions about risk such as nonperformance risk in liability fair values, and is a market-based measurement, not an entity-specific measurement. When considering the assumptions that market participants would use in pricing the asset or liability, this accounting standard establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

The fair value hierarchy prioritizes inputs used to measure fair value into three broad levels.

**Level 1 inputs** - In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that we have the ability to access.

**Level 2 inputs** - Fair values determined by Level 2 inputs use inputs other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets where there are few transactions and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

**Level 3 inputs** - Level 3 inputs are unobservable inputs for the asset or liability and include situations where there is little, if any, market activity for the asset or liability.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The following table presents information about our assets and liabilities recorded in our consolidated statement of financial position at their fair value on a recurring basis as of December 31, 2019 and December 31, 2018, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

	December 31, 2019	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
		(In Thousands)		
<b>Assets</b>				
Available for sale securities				
Mortgage-backed securities	\$ 34,150	-	34,150	-
Collateralized mortgage obligations				
Government sponsored enterprise issued	81,754	-	81,754	-
Municipal securities	53,692	-	53,692	-
Other debt securities	8,880	-	8,880	-
Loans held for sale	220,123	-	220,123	-
Mortgage banking derivative assets	1,835	-	-	1,835
Interest rate swap assets	680	-	680	-
<b>Liabilities</b>				
Mortgage banking derivative liabilities	-	-	-	-
Interest rate swap liabilities	680	-	680	-

	December 31, 2018	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
		(In Thousands)		
<b>Assets</b>				
Available for sale securities				
Mortgage-backed securities	\$ 41,631	-	41,631	-
Collateralized mortgage obligations				
Government sponsored enterprise issued	74,955	-	74,955	-
Municipal securities	55,948	-	55,948	-
Other debt securities	13,186	-	13,186	-
Loans held for sale	141,616	-	141,616	-
Mortgage banking derivative assets	2,014	-	-	2,014
<b>Liabilities</b>				
Mortgage banking derivative liabilities	1,116	-	-	1,116

The following summarizes the valuation techniques for assets and liabilities recorded in our consolidated statements of financial condition at their fair value on a recurring basis:

Available for sale securities – The Company's investment securities classified as available for sale include: mortgage-backed securities, collateralized mortgage obligations, government sponsored enterprise bonds, municipal securities and other debt securities. The fair value of mortgage-backed securities, collateralized mortgage obligations and government sponsored enterprise bonds are determined by a third party valuation source using observable market data utilizing a matrix or multi-dimensional relational pricing model. Standard inputs to these models include observable market data such as benchmark yields, reported trades, broker quotes, issuer spreads, benchmark securities, prepayment models and bid/offer market data. For securities with an early redemption feature, an option adjusted spread model is utilized to adjust the issuer spread. These model and matrix measurements are classified as Level 2 in the fair value hierarchy. The fair value of municipal and other debt securities is determined by a third party valuation source using observable market data utilizing a multi-dimensional relational pricing model. Standard inputs to this model include observable market data such as benchmark yields, reported trades, broker quotes, rating updates and issuer spreads. These model measurements are classified as Level 2 in the fair value hierarchy. The change in fair value is recorded through an adjustment to the statement of comprehensive income.

Loans held for sale – The Company carries loans held for sale at fair value under the fair value option model. Fair value is generally determined by estimating a gross premium or discount, which is derived from pricing currently observable in the secondary market, principally from observable prices for forward sale commitments. Loans held-for-sale are considered to be Level 2 in the fair value hierarchy of valuation techniques. The change in fair value is recorded through an adjustment to the statement of operations.

Mortgage banking derivatives - Mortgage banking derivatives include interest rate lock commitments to originate residential loans held for sale to individual customers and forward commitments to sell residential mortgage loans to various investors. The Company utilizes a valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale, which includes applying a pull through rate based upon historical experience and the current interest rate environment and then multiplying by quoted investor prices. The Company also utilizes a valuation model to estimate the fair value of its forward commitments to sell residential loans, which includes matching specific terms and maturities of the forward commitments against applicable investor pricing available. While there are Level 2 and 3 inputs used in the valuation models, the Company has determined that one or more of the inputs significant in the valuation of both of the mortgage banking derivatives fall within Level 3 of the fair value hierarchy. The change in fair value is recorded through an adjustment to the statement of operations, within mortgage banking income.

Interest rate swap assets/liabilities - The Company offers loan level swaps to its customers and offsets its exposure from such contracts by entering into mirror image swaps with a financial institution / swap counterparty. The fair values of derivatives are based on valuation models using observable market data as of the measurement date. Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. Interest rate swap assets and liabilities are considered to be Level 2 in the fair value hierarchy of valuation techniques. The change in fair value is recorded through an adjustment to the statement of operations, within other income and other expense.

The table below presents reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2019 and 2018.

	<b>Mortgage banking derivatives, net</b>
Balance at December 31, 2017	\$ 2,004
Transfer into level 3	-
Mortgage derivative loss, net	(1,106)
Balance at December 31, 2018	<u>898</u>
Transfer into level 3	-
Mortgage derivative gain, net	937
Balance at December 31, 2019	<u>\$ 1,835</u>

### Assets Recorded at Fair Value on a Non-recurring Basis

The following table presents information about our assets recorded in our consolidated statement of financial position at their fair value on a non-recurring basis as of December 31, 2019 and December 31, 2018, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

	Fair Value Measurements Using			
	December 31, 2019	Level 1	Level 2	Level 3
Impaired loans, net (1)	\$ 185	-	-	185
Real estate owned	748	-	-	748
Impaired mortgage servicing rights	206	-	-	206

	Fair Value Measurements Using			
	December 31, 2018	Level 1	Level 2	Level 3
Impaired loans, net (1)	\$ 2,876	-	-	2,876
Real estate owned	2,152	-	-	2,152

(1) Represents collateral-dependent impaired loans, net, which are included in loans.

Loans – We do not record loans at fair value on a recurring basis. On a non-recurring basis, loans determined to be impaired are analyzed to determine whether a collateral shortfall exists, and if such a shortfall exists, are recorded on our consolidated statements of financial condition at net realizable value of the underlying collateral. Fair value is determined based on third party appraisals. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of impaired loans, loans that have been deemed to be impaired are considered to be Level 3 in the fair value hierarchy of valuation techniques. At December 31, 2019, loans determined to be impaired with an outstanding balance of \$224,000 were carried net of specific reserves of \$39,000 for a fair value of \$185,000. At December 31, 2018, loans determined to be impaired with an outstanding balance of \$3.1 million were carried net of specific reserves of \$186,000 for a fair value of \$2.9 million. Impaired loans collateralized by assets which are valued in excess of the net investment in the loan do not require any specific reserves.

Real estate owned – On a non-recurring basis, real estate owned, is recorded in our consolidated statements of financial condition at the lower of cost or fair value. Fair value is determined based on third party appraisals and, if less than the carrying value of the foreclosed loan, the carrying value of the real estate owned is adjusted to the fair value. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of the properties, real estate owned is considered to be Level 3 in the fair value hierarchy of valuation techniques. There were no changes in the fair value of real estate owned for the year ended December 31, 2019. Changes in the fair value of real estate owned was \$309,000 for the year ended December 31, 2018 and are recorded in real estate owned expense. At December 31, 2019 and December 31, 2018, real estate owned totaled \$748,000 and \$2.2 million, respectively.

Mortgage servicing rights - The Company utilizes an independent valuation from a third party which uses a discounted cash flow model to estimate the fair value of mortgage servicing rights. The model utilizes prepayment assumptions to project cash flows related to the mortgage servicing rights based upon the current interest rate environment, which is then discounted to estimate an expected fair value of the mortgage servicing rights. The model considers characteristics specific to the underlying mortgage portfolio, such as: contractually specified servicing fees, prepayment assumptions, delinquency rates, late charges and costs to service. Given the significance of the unobservable inputs utilized in the estimation process, mortgage servicing rights are classified as Level 3 within the fair value hierarchy. The Company records the mortgage servicing rights at the lower of amortized cost or fair value. For the purpose of measuring impairment, mortgage servicing rights are stratified based upon predominant risk characteristics of the underlying loans. At December 31, 2019, there was \$77,000 of impairment on mortgage servicing rights. At December 31, 2018, there was no impairment identified for mortgage servicing rights.

For Level 3 assets and liabilities measured at fair value on a non-recurring basis, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value at December 31, 2019	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value	
				Minimum Value	Maximum Value
Mortgage banking derivatives	1,835,000	Pricing models	Pull through rate	24.8%	100.0%
Impaired loans	185,000	Market approach	Discount rates applied to appraisals	15.0%	15.0%
			Discount rates applied to appraisals	36.1%	65.2%
Real estate owned	748,000	Market approach	Prepayment rate	12.8%	30.0%
Mortgage servicing rights	282,000	Pricing models	Discount rate	11.0%	12.1%
			Cost to service	\$ 82.00	\$ 247.00

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Fair value information about financial instruments follows, whether or not recognized in the consolidated statements of financial condition, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The carrying amounts and fair values of the Company's financial instruments consist of the following at December 31, 2019 and December 31, 2018:

	December 31, 2019					December 31, 2018				
	Carrying amount	Fair Value				Carrying amount	Fair Value			
		Total	Level 1	Level 2	Level 3		Total	Level 1	Level 2	Level 3
			(In Thousands)							
<b>Financial Assets</b>										
Cash and cash equivalents	\$ 74,300	74,300	65,800	8,500	-	86,101	86,101	73,601	12,500	-
Securities available-for-sale	178,476	178,476	-	178,476	-	185,720	185,720	-	185,720	-
Loans held for sale	220,123	220,123	-	220,123	-	141,616	141,616	-	141,616	-
Loans receivable	1,388,031	1,426,224	-	-	1,426,224	1,379,148	1,311,633	-	-	1,311,633
FHLB stock	21,150	21,150	-	21,150	-	19,350	19,350	-	19,350	-
Accrued interest receivable	5,344	5,344	5,344	-	-	5,337	5,337	5,337	-	-
Mortgage servicing rights	282	282	-	-	282	109	109	-	-	109
Mortgage banking derivative assets	1,835	1,835	-	-	1,835	2,014	2,014	-	-	2,014
Interest rate swap assets	680	680	-	680	-	-	-	-	-	-
<b>Financial Liabilities</b>										
Deposits	1,067,776	1,070,083	328,005	742,078	-	1,038,495	1,038,544	302,622	735,922	-
Advance payments by borrowers for taxes	4,212	4,212	4,212	-	-	4,371	4,371	4,371	-	-
Borrowings	483,562	483,846	-	483,846	-	435,046	432,269	-	432,269	-
Accrued interest payable	1,559	1,559	1,559	-	-	1,395	1,395	1,395	-	-
Mortgage banking derivative liabilities	-	-	-	-	-	1,116	1,116	-	-	1,116
Interest rate swap liabilities	680	680	-	680	-	-	-	-	-	-

The following methods and assumptions were used by the Company in determining its fair value disclosures for financial instruments.

#### *Cash and Cash Equivalents*

The carrying amount reported in the consolidated statements of financial condition for cash and cash equivalents is a reasonable estimate of fair value. The commercial paper instruments with a maturity of less than 90 days also approximates its fair value with its carrying value.

#### *Securities*

The fair value of securities is determined by a third party valuation source using observable market data utilizing a matrix or multi-dimensional relational pricing model. Standard inputs to these models include observable market data such as benchmark yields, reported trades, broker quotes, issuer spreads, benchmark securities and bid/offer market data. For securities with an early redemption feature, an option adjusted spread model is utilized to adjust the issuer spread. Prepayment models are used for mortgage related securities with prepayment features.

### ***Loans Held for Sale***

Fair value is estimated using the prices of the Company's existing commitments to sell such loans and/or the quoted market price for commitments to sell similar loans.

### ***Loans Receivable***

The fair value estimation process for the loan portfolio uses an exit price concept and reflects discounts the Company believes are consistent with discounts in the market place. Fair values are estimated for portfolios of loans with similar characteristics. Loans are segregated by type such as one- to four-family, multi-family, home equity, construction and land, commercial real estate, commercial, and other consumer. The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for similar maturities. The fair value analysis also includes other assumptions to estimate fair value, intended to approximate those a market participant would use in an orderly transaction, with adjustments for discount rates, interest rates, liquidity, and credit spreads, as appropriate.

### ***FHLB Stock***

For FHLB stock, the carrying amount is the amount at which shares can be redeemed with the FHLB and is a reasonable estimate of fair value.

### ***Deposits and Advance Payments by Borrowers for Taxes***

The fair values for interest-bearing and noninterest-bearing negotiable order of withdrawal accounts, savings accounts, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates of similar remaining maturities to a schedule of aggregated expected monthly maturities of the outstanding certificates of deposit. The advance payments by borrowers for taxes are equal to their carrying amounts at the reporting date.

### ***Borrowings***

Fair values for borrowings are estimated using a discounted cash flow calculation that applies current interest rates to estimated future cash flows of the borrowings.

### ***Accrued Interest Payable and Accrued Interest Receivable***

For accrued interest payable and accrued interest receivable, the carrying amount is a reasonable estimate of fair value.

### ***Commitments to Extend Credit and Standby Letters of Credit***

Commitments to extend credit and standby letters of credit are generally not marketable. Furthermore, interest rates on any amounts drawn under such commitments would be generally established at market rates at the time of the draw. Fair values for the Company's commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the counterparty's credit standing, and discounted cash flow analyses. The fair value of the Company's commitments to extend credit was not material at December 31, 2019 and December 31, 2018.

### ***Mortgage Banking Derivative Assets and Liabilities***

Mortgage banking derivatives include interest rate lock commitments to originate residential loans held for sale to individual customers and forward commitments to sell residential mortgage loans to various investors. The Company relies on a valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale, which includes applying a pull through rate based upon historical experience and the current interest rate environment, and then multiplying by quoted investor prices. The Company also relies on a valuation model to estimate the fair value of its forward commitments to sell residential loans, which includes matching specific terms and maturities of the forward commitments against applicable investor pricing available. On the Company's Consolidated Statements of Condition, instruments that have a positive fair value are included in prepaid expenses and other assets, and those instruments that have a negative fair value are included in other liabilities.

### ***Interest Rate Swap Assets and Liabilities***

The carrying value and fair value of existing derivative financial instruments are based upon independent valuation models, which use widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative contract. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

## 17) Earnings Per Share

Earnings per share are computed using the two-class method. Basic earnings per share is computed by dividing net income allocated to common shares by the weighted average number of common shares outstanding during the applicable period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding adjusted for the dilutive effect of all potential common shares.

Presented below are the calculations for basic and diluted earnings per share:

	For the year ended December 31,		
	2019	2018	2017
	(In Thousands, except per share amounts)		
Net income	\$ 35,903	30,754	25,964
Weighted average shares outstanding	26,021	27,363	27,467
Effect of dilutive potential common shares	226	271	432
Diluted weighted average shares outstanding	<u>26,247</u>	<u>27,634</u>	<u>27,899</u>
Basic income per share	\$ <u>1.38</u>	<u>1.12</u>	<u>0.95</u>
Diluted income per share	\$ <u>1.37</u>	<u>1.11</u>	<u>0.93</u>

18) Condensed Parent Company Only Statements

Statements of Financial Condition

	December 31,	
	2019	2018
	(In Thousands)	
<b>Assets</b>		
Cash and cash equivalents	\$ 54,730	20,116
Investment in subsidiaries	342,295	380,897
Other assets	187	2,476
Total Assets	<u>\$ 397,212</u>	<u>403,489</u>
<b>Liabilities and shareholders' equity</b>		
<b>Liabilities:</b>		
Other liabilities	\$ 3,526	3,810
<b>Shareholders' equity</b>		
Preferred Stock (par value \$.01 per share), Authorized - 50,000,000 shares in 2019 and 2018, no shares issued	-	-
Common stock (par value \$.01 per share), Authorized - 100,000,000 shares in 2019 and in 2018, Issued - 27,148,411 in 2019 and 28,463,239 in 2018, Outstanding - 27,148,411 in 2019 and 28,463,239 in 2018	271	285
Additional paid-in-capital	211,997	232,406
Retained earnings	197,393	187,153
Unearned ESOP shares	(16,617)	(17,804)
Accumulated other comprehensive gain (loss) (net of taxes)	642	(2,361)
Total shareholders' equity	<u>393,686</u>	<u>399,679</u>
Total liabilities and shareholders' equity	<u>\$ 397,212</u>	<u>403,489</u>

Statements of Operations

	For the year ended December 31,		
	2019	2018	2017
	(In Thousands)		
Interest income	\$ 793	656	675
Equity in income of subsidiaries (distributed and undistributed)	35,784	30,722	25,937
Total income	<u>36,577</u>	<u>31,378</u>	<u>26,612</u>
Professional fees	58	37	57
Other expense	577	577	575
Total expense	<u>635</u>	<u>614</u>	<u>632</u>
Income before income tax expense	35,942	30,764	25,980
Income tax expense	39	10	16
Net income	<u>\$ 35,903</u>	<u>30,754</u>	<u>25,964</u>



**Statements of Cash Flows**

	<b>For the year ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
		(In Thousands)	
Cash flows from operating activities			
Net income	\$ 35,903	30,754	25,964
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Amortization of unearned ESOP	1,805	1,796	1,956
Stock based compensation	1,067	1,760	1,902
Deferred income taxes	-	-	(58)
Equity in earnings of subsidiaries	(35,784)	(30,722)	(25,937)
Change in other assets and liabilities	1,235	(4,019)	530
Net cash provided by (used in) operating activities	4,226	(431)	4,357
Net cash used in investing activities	-	-	-
Dividends received from subsidiary	78,456	36,535	14,698
Cash dividends on common stock	(25,960)	(27,050)	(26,952)
Proceeds from stock option exercises	659	1,304	1,052
Purchase of common stock returned to authorized but unissued	(22,767)	(19,196)	(2,190)
Net cash provided by (used in) financing activities	30,388	(8,407)	(13,392)
Net increase (decrease) in cash	34,614	(8,838)	(9,035)
Cash and cash equivalents at beginning of year	20,116	28,954	37,989
Cash and cash equivalents at end of year	\$ 54,730	20,116	28,954

**19) Segment Reporting**

Selected financial and descriptive information is required to be provided about reportable operating segments, considering a "management approach" concept as the basis for identifying reportable segments. The management approach is based on the way that management organizes the segments within the enterprise for making operating decisions, allocating resources, and assessing performance. Consequently, the segments are evident from the structure of the enterprise's internal organization, focusing on financial information that an enterprise's chief operating decision-makers use to make decisions about the enterprise's operating matters.

The Company has determined that it has two reportable segments: community banking and mortgage banking. The Company's operating segments are presented based on its management structure and management accounting practices. The structure and practices are specific to the Company and therefore, the financial results of the Company's business segments are not necessarily comparable with similar information for other financial institutions.

**Community Banking**

The Community Banking segment provides consumer and business banking products and services to customers primarily within Southeastern Wisconsin along with a loan production office in Minneapolis, Minnesota. Within this segment, the following products and services are provided: (1) lending solutions such as residential mortgages, home equity loans and lines of credit, personal and installment loans, real estate financing, business loans, and business lines of credit; (2) deposit and transactional solutions such as checking, credit, debit and pre-paid cards, online banking and bill pay, and money transfer services; (3) investable funds solutions such as savings, money market deposit accounts, IRA accounts, certificates of deposit, and (4) fixed and variable annuities, insurance as well as trust and investment management accounts.

Consumer products include loan and deposit products: mortgage, home equity loans and lines, personal term loans, demand deposit accounts, interest bearing transaction accounts and time deposits. Consumer products also include personal investment services. Business banking products include secured and unsecured lines and term loans for working capital, inventory and general corporate use, commercial real estate construction loans, demand deposit accounts, interest bearing transaction accounts and time deposits.

#### Mortgage Banking

The Mortgage Banking segment provides residential mortgage loans for the primary purpose of sale in the secondary market. Mortgage banking products and services are provided by offices in 24 states with the ability to lend in 48 states.

	<b>As of or for the Year ended December 31, 2019</b>			
	<b>Community Banking</b>	<b>Mortgage Banking</b>	<b>Holding Company and Other</b>	<b>Consolidated</b>
	(in thousands)			
Net interest income (loss)	\$ 54,019	(1,910)	88	52,197
Provision (credit) for loan losses	(1,050)	150	-	(900)
Net interest income (loss) after provision for loan losses	<u>55,069</u>	<u>(2,060)</u>	<u>88</u>	<u>53,097</u>
Noninterest income	5,020	126,910	(1,180)	130,750
<b>Noninterest expenses:</b>				
Compensation, payroll taxes, and other employee benefits	18,195	84,230	(707)	101,718
Occupancy, office furniture, and equipment	3,752	6,854	-	10,606
Advertising	920	2,965	-	3,885
Data processing	2,121	1,493	16	3,630
Communications	358	1,001	-	1,359
Professional fees	813	2,734	58	3,605
Real estate owned	(176)	30	-	(146)
Loan processing expense	-	3,288	-	3,288
Other	2,205	6,741	(618)	8,328
Total noninterest expenses	<u>28,188</u>	<u>109,336</u>	<u>(1,251)</u>	<u>136,273</u>
Income before income taxes	31,901	15,514	159	47,574
Income taxes	7,296	4,336	39	11,671
Net income	<u>\$ 24,605</u>	<u>11,178</u>	<u>120</u>	<u>35,903</u>
Total Assets	\$ 1,955,999	258,928	(218,580)	1,996,347

## As of or for the Year ended December 31, 2018

	<u>Community Banking</u>	<u>Mortgage Banking</u>	<u>Holding Company and Other</u>	<u>Consolidated</u>
	(in thousands)			
Net interest income	\$ 54,946	(850)	81	54,177
Provision (credit) for loan losses	(1,150)	90	-	(1,060)
Net interest income (loss) after provision for loan losses	<u>56,096</u>	<u>(940)</u>	<u>81</u>	<u>55,237</u>
Noninterest income	4,299	115,429	(1,529)	118,199
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	18,385	79,982	(583)	97,784
Occupancy, office furniture and equipment	3,307	7,548	-	10,855
Advertising	749	3,374	-	4,123
Data processing	1,671	1,105	16	2,792
Communications	425	1,186	-	1,611
Professional fees	967	1,343	17	2,327
Real estate owned	1	-	-	1
Loan processing expense	-	3,372	-	3,372
Other	2,715	8,522	(946)	10,291
Total noninterest expenses	<u>28,220</u>	<u>106,432</u>	<u>(1,496)</u>	<u>133,156</u>
Income before income taxes	32,175	8,057	48	40,280
Income taxes	7,273	2,243	10	9,526
Net income	<u>\$ 24,902</u>	<u>5,814</u>	<u>38</u>	<u>30,754</u>
Total Assets	\$ 1,913,647	166,926	(165,192)	1,915,381

## As of or for the Year ended December 31, 2017

	<b>Community Banking</b>	<b>Mortgage Banking</b>	<b>Holding Company and Other</b>	<b>Consolidated</b>
	(in thousands)			
Net interest income	\$ 50,608	(49)	174	50,733
Provision (credit) for loan losses	(1,300)	134	-	(1,166)
Net interest income (loss) after provision for loan losses	51,908	(183)	174	51,899
Noninterest income	3,942	122,091	(1,620)	124,413
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	17,495	80,077	(488)	97,084
Occupancy, office furniture and equipment	3,127	7,051	-	10,178
Advertising	627	2,706	-	3,333
Data processing	1,619	805	15	2,439
Communications	408	1,152	-	1,560
Professional fees	782	1,837	37	2,656
Real estate owned	379	-	-	379
Loan processing expense	-	3,062	-	3,062
Other	2,828	9,400	(1,040)	11,188
Total noninterest expenses	27,265	106,090	(1,476)	131,879
Income before income taxes	28,585	15,818	30	44,433
Income taxes	12,228	6,225	16	18,469
Net income	\$ 16,357	9,593	14	25,964
Total Assets	\$ 1,834,191	173,237	(201,027)	1,806,401

## 20) Business Combination

### *Academy Mortgage Corporation Branch*

On June 29, 2018, Waterstone Mortgage Corporation, a subsidiary of WaterStone Bank SSB, completed an acquisition of a branch of Academy Mortgage Corporation ("Academy"), a mortgage banking company in New Mexico. Waterstone Mortgage Corporation paid Academy approximately \$600,000 in cash for the transaction.

Waterstone Mortgage Corporation's acquisition of the branch was accounted for as a business combination. Under the transaction, fixed assets and a customer list were acquired and the branch leases were assumed. Under this method of accounting, assets acquired are recorded at their estimated fair values. Total consideration paid less the fair value of assets acquired was recorded as goodwill. The Company recorded an insignificant amount of goodwill as a result of this acquisition.

## 21) Leases

The Company has entered into operating lease agreements for two of its community banking branch locations, all of its mortgage banking office locations, and some of its office equipment. The leases have fixed terms defined regarding the payments and length. The Company elected not to include short-term leases (i.e., leases with initial terms of twelve months or less), or equipment leases (deemed immaterial) on the consolidated statements of financial condition. Some of the leases included options to extend the leases. These options are reviewed and factored into the length of the lease if the option is expected to be extended. Leases did not contain an implicit rate; therefore, the Company used the incremental borrowing rates for the discount rate. There were no sale and leaseback transactions, leveraged leases, or lease transactions with related parties during the twelve months ended December 31, 2019.

At December 31, 2019, the Company had lease liabilities totaling \$8.9 million and right-of-use assets totaling \$8.4 million related to these leases. Lease liabilities and right-of-use assets are reflected in other liabilities and other assets, respectively, on the consolidated statements of financial condition.

The cost components of our operating leases were as follows for the year ended December 31, 2019:

	<b>Year ended December 31, 2019</b>
	(In Thousands)
Operating lease cost	\$ 2,988
Variable cost	822
Short-term lease cost	965
Total	<u>\$ 4,775</u>

At December 31, 2019, the Company had leases that had not yet commenced, but will create approximately \$200,000 of additional lease liabilities and right-of-use assets for the Company in the first quarter of 2020.

The table below summarizes other information related to our operating leases:

	<b>Year ended December 31, 2019</b>
	(Dollars in Millions)
Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from operating leases	\$ 3.2
Initial recognition of right-of-use asset	11.4
Initial recognition of lease liabilities	11.9
Weighted average remaining lease term - operating leases, in years	3.11
Weighted average discount rate - operating leases	5.9%

As of December 31, 2019, lease liability information for the Company is summarized in the following table.

<b>Maturity analysis</b>	<b>Operating leases</b>
	(In Thousands)
One year or less	\$ 3,222
More than one year through two years	2,490
More than two years through three years	1,683
More than three years through four years	1,259
More than four years through five years	515
More than five years	983
Total lease payments	10,152
Present value discount	(1,272)
Lease liability	\$ 8,880

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

**Item 9A. Controls and Procedures**

**Disclosure Controls and Procedures:** The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

**Change in Internal Control Over Financial Reporting:** There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the final fiscal quarter of the period to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## Management's Annual Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Exchange Act.

As of December 31, 2019, management assessed the effectiveness of the Company's internal control over financial reporting based on criteria for effective internal control over financial reporting established in "Internal Control—Integrated Framework," issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO) in 2013. Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2019 is effective.

RSM US LLP, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued a report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2019. The report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2019, is included below under the heading "Report of Independent Registered Public Accounting Firm."

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors of Waterstone Financial, Inc.

#### Opinion on the Internal Control Over Financial Reporting

We have audited Waterstone Financial Inc. and Subsidiaries' (the Company) internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements of the Company and our report dated March 13, 2020 expressed an unqualified opinion.

#### Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

#### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ RSM US LLP

Chicago, Illinois  
March 13, 2020

**Item 9B. Other Information**

None

**Part III****Item 10. Directors, Executive Officers and Corporate Governance**

The information in the Company's definitive Proxy Statement, prepared for the 2020 Annual Meeting of Shareholders, which contains information concerning directors of the Company under the caption "Proposal 1 - Election of Directors" and compliance with Section 16 reporting requirements under the caption "Delinquent Section 16(a) Reports" continued below and information concerning corporate governance under the caption "Other Board and Corporate Governance Matters" and "Board Meetings and Committees" in Part I hereof is incorporated herein by reference.

**Executive Officers of the Registrant**

The table below sets forth certain information regarding the persons who have been determined, by our board of directors, to be executive officers of the Company. The executive officers of the Company are elected annually and hold office until their respective successors have been elected or until death, resignation, retirement or removal by the Board of directors.

<b>Name and Age</b>	<b>Offices and Positions with Waterstone Financial and Subsidiaries*</b>	<b>Executive Officer Since</b>
Douglas S. Gordon, 62	Chief Executive Officer and President of Waterstone Financial and of WaterStone Bank	2005
William F. Bruss, 50	General Counsel, Executive Vice President and Secretary of Waterstone Financial and of WaterStone Bank	2005
Mark R. Gerke, 45	Chief Financial Officer and Vice President of Waterstone Financial and of WaterStone Bank	2016
Andy Peach, 54	Chief Executive Officer and President of Waterstone Mortgage Corporation	2019
Julie A. Glynn, 56	Senior Vice President and Director of Retail Banking of WaterStone Bank	2018

\* Excluding directorships and excluding positions with Bank subsidiary that do not constitute a substantial part of the officers' duties.

**Item 11. Executive Compensation**

The information in the Company's definitive Proxy Statement, prepared for the 2020 Annual Meeting of Shareholders, which contains information concerning this item under the captions "Executive Compensation," "Director Compensation," "Compensation Committee Interlocks and Insider Participation," "Compensation Discussion and Analysis," and "Compensation Committee Report" is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information in the Company's definitive Proxy Statement, prepared for the 2020 Annual Meeting of Shareholders, which contains information concerning this item under the caption "Beneficial Ownership of Common Stock" is incorporated herein by reference.

**Compensation Plans**

Set forth below is information as of December 31, 2019 regarding equity compensation plans that have been approved by shareholders. The Company has no equity based benefit plans, other than its employee stock ownership plan, that were not approved by shareholders.

<b>Plan</b>	<b>Number of shares to be issued upon exercise of outstanding options and rights</b>	<b>Weighted average option exercise price</b>	<b>Number of securities remaining available for issuance under plan</b>
2006 Equity Incentive Plan	1,366,301 <sup>(1)</sup>	\$ 4.20	102,322
2015 Equity Incentive Plan	1,759,000 <sup>(2)</sup>	\$ 13.27	1,783,000

(1) Consists of 1,000,140 shares reserved for grants of stock options and 366,161 shares reserved for grants of restricted stock. On December 31, 2019, 7,237 options were outstanding with a weighted average exercise price of \$4.20 of which 7,237 were exercisable as of that date.

(2) Consists of 1,213,000 shares reserved for grants of stock options and 546,000 shares reserved for grants of restricted stock. On December 31, 2019, 1,053,832 options were outstanding with a weighted average exercise price of \$13.27 of which 413,831 were exercisable as of that date.



**Item 13. Certain Relationships and Related Transactions and Director Independence**

The information in the Company's definitive Proxy Statement, prepared for the 2020 Annual Meeting of Shareholders, which contains information concerning this item under the captions "Transactions with Certain Related Parties" and "Board Meetings and Committees" is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

The information in the Company's definitive Proxy Statement, prepared for the 2020 Annual Meeting of Shareholders, which contains information concerning this item under the caption "Ratification of the Appointment of Our Independent Registered Public Accounting Firm," is incorporated herein by reference.

**Part IV**

**Item 15. Exhibits and Financial Statement Schedules**

- (a) Documents filed as part of the Report:  
1. and 2. Financial Statements and Financial Statement Schedules.

The following consolidated financial statements of Waterstone Financial, Inc. and subsidiaries are filed as part of this report under Item 8, "Financial Statements and Supplementary Data":

Report of RSM US LLP, Independent Registered Public Accounting Firm, on consolidated financial statements.

Consolidated Statements of Financial Condition – December 31, 2019 and 2018.

Consolidated Statements of Operations – Years ended December 31, 2019, 2018 and 2017.

Consolidated Statements of Comprehensive Income – Years ended December 31, 2019, 2018 and 2017.

Consolidated Statements of Changes in Shareholders' Equity – Years ended December 31, 2019, 2018 and 2017.

Consolidated Statements of Cash Flows – Years ended December 31, 2019, 2018 and 2017.

Notes to Consolidated Financial Statements.

All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

- (b). Exhibits. See Exhibit Index following the signature page of this report, which is incorporated herein by reference. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report is identified in the Exhibit Index by an asterisk following its exhibit number.

**Item 16. Form 10-K Summary**

**Not applicable.**

**WATERSTONE FINANCIAL, INC**  
**(“Waterstone Financial” or the “Company”)**  
**Commission File No. 000-51507**

**EXHIBIT INDEX**  
**TO**  
**2019 REPORT ON FORM 10-K**

The following exhibits are filed with, or incorporated by reference in, this Annual Report on Form 10-K for the year ended December 31, 2019:

Exhibit	Description	Incorporated Herein By Reference To	Filed Herewith
3.1	<u>Articles of Incorporation of the Company (3)</u>		
3.2	<u>Bylaws of the Company (3)</u>		
4.1	<u>Common Stock Certificate (1)</u>		
4.2	<u>Description of Registrant’s Securities</u>		X
10.1	<u>Wauwatosa Holdings, Inc 2006 Equity Incentive Plan †(2)</u>		
10.2	<u>Waterstone Financial, Inc. 2015 Equity Incentive Plan †(3)</u>		
10.3	<u>Employment Agreement By and Between WaterStone Bank SSB and Douglas S. Gordon †(4)</u>		
10.4	<u>Change in Control Agreement Between WaterStone Bank SSB and Julie Glynn †(5)</u>		
10.5	<u>Resignation and Release Agreement Between Waterstone Mortgage Corporation and Eric J. Egenhoefer †(7)</u>		
10.6	<u>Waterstone Financial, Inc. Incentive Plan †(6)</u>		
10.7	<u>Employment Agreement By and Between Waterstone Mortgage Corporation and Andy Peach †(8)</u>		
21.1	<u>List of Subsidiaries</u>		X
23.1	<u>Consent of Independent Registered Public Accounting Firm</u>		X
24.1	<u>Powers of Attorney</u>	Signature Page	
31.1	<u>Sarbanes-Oxley Act Section 302 Certification signed by the Chief Executive Officer of Waterstone Financial</u>		X
31.2	<u>Sarbanes-Oxley Act Section 302 Certification signed by the Chief Financial Officer of Waterstone Financial</u>		X
32.1	<u>Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Executive Officer of Waterstone Financial</u>		X
32.2	<u>Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Financial Officer of Waterstone Financial</u>		X

† Management compensation contract or agreement

(1) Incorporated by reference to the registration Statement on Form S-1 filed by Wauwatosa Holdings, Inc. (the predecessor corporation to Waterstone Financial, Inc., a federal corporation) (Commission file no. 333-125715), filed with the U.S. Securities and Exchange Commission on June 10, 2005.

(2) Incorporated by reference to Appendix A to the Definitive Proxy Statement for the 2006 Annual Meeting of Shareholders filed by Wauwatosa Holdings, Inc. (the predecessor corporation to Waterstone Financial, Inc., a federal corporation) (Commission file no. 000-51507), filed with the U.S. Securities and Exchange Commission on March 27, 2006.

(3) Incorporated by reference to the registration Statement on Form S-1 (Registration No. 333-189160), initially filed with the U.S. Securities and Exchange Commission on June 7, 2013.

(4) Incorporated by reference to Exhibit 10.1 to Report on Form 8-K filed with the U.S. Securities and Exchange Commission on October 24, 2014 (File No. 001-36271).

(5) Incorporated by reference to Exhibit 10.6 to Report on Form 10-K filed with the U.S. Securities and Exchange Commission on March 6, 2019 (File No. 001-36271).

(6) Incorporated by reference to Exhibit 10.1 to Report on Form 8-K filed with the U.S. Securities and Exchange Commission on March 25, 2019 (File No. 001-36271).

(7) Incorporated by reference to Exhibit 10.1 to Report on Form 8-K filed with the U.S. Securities and Exchange Commission on April 4 2019 (File No. 001-36271).

(8) Incorporated by reference to Exhibit 10.1 to the Consent Report on Form 8-K filed with the SEC on September 19, 2019 (File No. 001-36271).

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

March 13, 2020

WATERSTONE FINANCIAL, INC.

By: /s/ Douglas S. Gordon  
Douglas S. Gordon  
*Chief Executive Officer*

**POWER OF ATTORNEY**

Each person whose signature appears below hereby authorizes Douglas S. Gordon or Mark R. Gerke, or any of them, as attorneys-in-fact with full power of substitution, to execute in the name and on behalf of such person, individually, and in each capacity stated below or otherwise, and to file, any and all amendments to this report.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated.\*

**Signature and Title**

/s/ Douglas S. Gordon  
Douglas S. Gordon,  
*Chief Executive Officer and Director*  
*(Principal Executive Officer)*

/s/ Mark R. Gerke  
Mark R. Gerke  
*Chief Financial Officer*

/s/ Patrick S. Lawton  
Patrick S. Lawton, *Chairman and Director*

/s/ Ellen S. Bartel  
Ellen S. Bartel, *Director*

/s/ Thomas E. Dalum  
Thomas E Dalum, *Director*

/s/ Michael L. Hansen  
Michael L. Hansen, *Director*

/s/ Kristine A. Rappé  
Kristine A. Rappé, *Director*

/s/ Stephen J. Schmidt  
Stephen J. Schmidt, *Director*

\*Each of the above signatures is affixed as of March 13, 2020.

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## Waterstone Financial, Inc. Directors

**PATRICK S. LAWTON**  
Chairman of the Board

**ELLEN S. BARTEL**

**THOMAS E. DALUM**

**DOUGLAS S. GORDON**

**MICHAEL L. HANSEN**

**KRISTINE A. RAPPÉ**

**STEPHEN J. SCHMIDT**

## Waterstone Financial, Inc. Officers

**DOUGLAS S. GORDON**  
Chief Executive Officer & President

**WILLIAM F. BRUSS**  
Chief Operating Officer, General Counsel & Secretary

**MARK R. GERKE**  
Chief Financial Officer & Executive Vice President

## Waterstone Mortgage Corporation Officers

**ANDY PEACH**  
Chief Executive Officer & President

**KEVIN ALLEN**  
Senior Vice President & National Sales Manager

**LISA FENSKE**  
Senior Vice President, Marketing & Communications

**CHRIS FLEMMING**  
Senior Vice President, National Sales

**TOM KNAPP**  
Senior Vice President & Chief Information Officer

**KIM NEWBY**  
Senior Vice President, Investor Relations & Product Development

**BOB SELINGO**  
Senior Vice President, Secondary Marketing

**ELIZABETH SPRAGG**  
Senior Vice President, Human Resources

**RICH TUCKER**  
Senior Vice President, Loan Operations

**STEPHANIE ZIEBELL**  
Vice President & General Counsel

**RSM US LLP**  
Auditors



## WaterStone Bank SSB Officers

**DOUGLAS S. GORDON**  
Chief Executive Officer  
& President

**WILLIAM F. BRUSS**  
Chief Operating Officer,  
General Counsel  
& Secretary

**MARK R. GERKE**  
Chief Financial Officer  
& Executive Vice President

**DON BRAY**  
Chief Information Officer  
& Senior Vice President

**JULIE GLYNN**  
Senior Vice President, Retail

**DAVID R. PROVANCHER**  
Chief Lending Officer  
& Senior Vice President

**MICHAEL BACKAUS**  
Vice President

**ANDREW T. BOARIO**  
Vice President

**CHRISTOPHER J. BROCK**  
Vice President

**DENNIS CREGAN**  
Director of Mortgage  
Banking Finance

**JAMES L. CROWLEY**  
Vice President

**TODD M. CRUCIANI**  
Vice President

**JULIE M. FAY-KRIVITZ**  
Vice President

**RYAN J. GORDON**  
Vice President  
& Chief Credit Officer

**MICHAEL S. GRIEBEL**  
Vice President

**MARGARET HAAGENSEN**  
Vice President

**JEFF JARECKI**  
Vice President

**JACK D. KAHL**  
Vice President

**COLLETTE M. KENDZIERSKI**  
Vice President

**SHAE MACLIN**  
Vice President

**JOHN M. MCCARTY**  
Vice President

**MEGAN A. MCCOY**  
Vice President

**KYLE J. MERTZ**  
Controller

**MARLENE D. MOLTER**  
Vice President

**JOSEPH MUDLAFF**  
Vice President

**PAUL MULDOON**  
Vice President

**THERESE M. PEKAR**  
Vice President

**KENNETH A. SNYDER**  
Vice President

**MICHAEL STOVER**  
Vice President

**JUDITH M. WAGNER**  
Vice President  
& Assistant Controller

**MARY C. BRUEGGEMAN**  
Treasury Officer

**KELLI S. GLATCZAK**  
Assistant Vice President

**JOHN HEIMSOTH**  
Assistant Vice President

**JEN HELLENDRUNG**  
Information Services Officer

**DENISE L. MIHALJEVIC**  
Legal Services Officer

**LAURA PINSON**  
Assistant Vice President

**AL SCHEINPLUG**  
Facilities Officer

**JODI STEPHENS**  
Benefits Officer

**ERIN MCCARTHY**  
Assistant Vice President,  
Regional Manager, Wauwatosa

**WENDY RICE**  
Assistant Vice President,  
Regional Manager, Oak Creek

**GRETCHEN CAMPBELL**  
Community President,  
West Allis/National Ave

**CAROL CAREY**  
Community President,  
Wauwatosa

**SHANDA CAVENEY**  
Community President,  
Oak Creek/Howell Ave

**JENNIFER DE NICOLA**  
Community President,  
Germantown/Menomonee Falls

**TIMOTHY KLARE**  
Community President,  
Waukesha

**JENNIFER LITKOWIEC**  
Community President,  
Oak Creek/27th St

**SHARRON SMITH**  
Community President,  
Pewaukee

**LAURA MERCHLE**  
Community President,  
Brookfield

**GINA RAFENSTEIN**  
Community President,  
Greenfield

**MEGAN WEIGAND**  
Community President,  
Fox Point/North Shore

**MORGAN STRANDT**  
Community President,  
Oconomowoc/Lake Country

Waterstone  
FINANCIAL, INC.

WATERSTONE  
BANK<sup>SSB</sup>

WATERSTONE  
INVESTMENT SERVICES

*Serving Wisconsin Area Locations*

Not FDIC Insured	No Bank Guarantee	Not a Bank Deposit
Not Insured by any Federal Government Agency	May Lose Value	

Securities offered through LPL Financial, Member FINRA/SIPC.  
Insurance products offered through LPL Financial or its licensed affiliates. WaterStone Bank and WaterStone Investment Services are not registered broker/dealers and are not affiliated with LPL Financial. Waterstone Financial, Inc., WaterStone Bank, Waterstone Mortgage and WaterStone Investment services are separate entities from LPL Financial.

Waterstone  
MORTGAGE

WATERSTONE FINANCIAL  
CORPORATE HEADQUARTERS  
11200 West Plank Court  
Wauwatosa, WI 53226