Waterstone
FINANCIAL, INC.
2020 Annual Report

# Dear Fellow Shareholder:

As we begin 2021, Happy New Year has never seemed so appropriate. Waterstone Financial had record results that were overshadowed by the impact the pandemic had on humanity. We worked extremely hard during the year to keep our employees, customers, and communities safe, while making all efforts to service their financial needs.

2021 marks the 100th anniversary of WaterStone Bank, and we continue to stand strong as a company. Our foundation resides in our dedicated employees, the exceptional products and services we provide, the great relationships with our customers, and our impact on the community we call "home".

Our financial results were outstanding, led by our mortgage banking segment originating a record $4.5 billion in residential home loans. The community banking segment added excellent operating results, 47% growth in transactional core deposits, and maintained strong asset quality metrics.

Despite the pandemic, we launched a new robust and innovative digital banking platform for businesses and consumers. In addition, we opened our first branch office in the City of Milwaukee – our 14th office overall.

We continue to enhance our shareholders' returns by declaring dividends of $1.28 per share and repurchasing 2.3 million shares of common stock during 2020. Even with these shareholder distributions, we still were able to increase book value per share by $1.97. Financially, it was a great year by any measurement.

On behalf of all of us at Waterstone Financial, we thank you for your continued support.

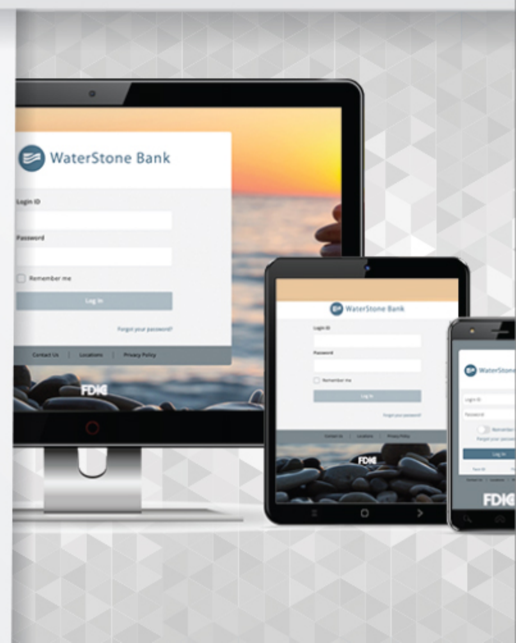
Sincerely,

Doug Gordon

Doug Gordon
President & CEO

# Highlights:

- Opened a new City of Milwaukee Branch located at 6801 W Oklahoma Ave
- Provided 275 PPP Loans (SBA's Paycheck Protection Program) to Local Businesses
- Launched Digital Banking with enhanced security, new technology & improved account management tools
- $750,000+ donated to 240+ local nonprofits & schools
- 571+ Employee Volunteer Hours



April 8, 2021

Dear Fellow Shareholder,

We invite you to attend the virtual Waterstone Financial, Inc. Annual Meeting of Shareholders, which will be held virtually at 9:00 a.m., Central Time, on Tuesday, May 18, 2021.

To participate in the meeting, visit www.cstproxy.com/wsbonline/2021, and enter the 12 digit control number included on your proxy card. You may register for the meeting as early as 9:00 a.m., Central Time, on May 13, 2021. Beneficial investors, who own their investments through a bank or broker, will need to contact Continental Stock Transfer to receive a control number. If you plan to vote at the meeting you will need to have a legal proxy from your bank or broker, or if you would like to join and not vote Continental will issue you a guest control number with proof of ownership. The contact information for Continental Stock Transfer is (917) 262-2373, or proxy@continentalstock.com.

If you do not wish to participate in the meeting, but you merely wish to listen to the proceedings, we have set up telephone access for those purposes. In that case, please call, toll-free (within the United States and Canada), 1-888-965-8995. If calling from outside the United States or Canada, please call +1 415-655-0243 (standard rates apply). The passcode for listening by telephone is 87197837#.

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 2020 Annual Report to Shareholders on Form 10-K and our Proxy Statement at www.cstproxy.com/wsbonline/2021. On April 8, 2021, 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, or by regular mail. 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 early as it will assure that your vote is counted if there are any unforeseen disruptions between now and May 18, 2021.

Sincerely,

Doug Gordon

**DOUGLAS S. GORDON**
Chief Executive Officer

**WATERSTONE FINANCIAL, INC.**

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

---

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD ON MAY 18, 2021

---

To the Shareholders of Waterstone Financial, Inc.:

The 2021 annual meeting of shareholders of Waterstone Financial, Inc. will be held virtually on Tuesday, May 18, 2021, at 9:00 a.m., Central Time, at www.cstproxy.com/wsbonline/2021 for the following purposes:

(1) Electing two directors to serve for a term expiring in 2024;
(2) Ratifying the selection of RSM US LLP as Waterstone Financial, Inc.'s independent registered public accounting firm;
(3) Approving an advisory, non-binding resolution to approve the executive compensation described in the Proxy Statement; and
(4) 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 24, 2021 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.

By Order of the Board of Directors

William F. Bruss
Executive Vice President and Secretary

Wauwatosa, Wisconsin
April 8, 2021

**PROXY STATEMENT**

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

---

**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 to be held virtually at www.cstproxy.com/wsbonline/2021 on Tuesday, May 18, 2021, and at any adjournment of the meeting. The 2020 Annual Report on Form 10-K is enclosed with the Proxy Statement and contains business and financial information concerning Waterstone Financial. Our proxy materials are being made available to shareholders on or about April 8, 2021.

*Record Date and Meeting Information.* As a registered stockholder, you received a proxy card, which contains instructions on how to attend the virtual annual meeting, including the website along with your control number. You will need your control number for access. If you do not have your control number, contact our transfer agent, Continental Stock Transfer at (917) 262-2373 or proxy@continentalstock.com.

If your shares of Company common stock are held by a bank, broker or other nominee, you will need to contact your bank, broker or other nominee and obtain a legal proxy. Once you have received your legal proxy, contact Continental Stock Transfer to have a control number generated. The contact information for Continental Stock Transfer is (917) 262-2373, or proxy@continentalstock.com.

A question and answer session will be held during the annual meeting, and stockholders will be able to submit questions prior to the meeting by visiting www.cstproxy.com/wsbonline/2021. Questions may be submitted as early as 9:00 a.m., Central Time, on May 13, 2021, but must be submitted by 12:00 p.m. Central Time on May 17, 2021. The Company will try to answer as many stockholder-submitted questions, as time permits, that comply with the meeting rules of conduct posted on the virtual annual meeting website.

*Record Date and Meeting Information.* The board of directors has fixed March 24, 2021 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 of Waterstone Financial stock 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 25,230,284 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 may vote either by mailing 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 virtually at the annual meeting. Virtual attendance at the annual meeting will not in itself constitute revocation of a proxy.

*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 11, 2021. 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 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, 2021.

As to Proposal 3, 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.

*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 2020 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 2020 Annual Report and/or this Proxy Statement. Stockholders sharing an address who are receiving multiple copies of this Proxy Statement and/or the 2020 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 24, 2021, 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 |
|---|---|---|
| 5% or Greater Shareholders | | |
| Renaissance Technologies LLC<br>Renaissance Technologies Holdings Corporation<br>800 Third Avenue<br>New York, New York 10022 | 1,910,044 (2) | 7.6% |
| Dimensional Fund Advisors LP<br>Building One<br>6300 Bee Cave Road<br>Austin, Texas 78746 | 1,959,852 (3) | 7.8% |
| BlackRock, Inc.<br>55 East 52nd Street<br>New York, New York 10055 | 1,837,873 (4) | 7.3% |
| 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<br>1013 Centre Road Suite 300<br>Wilmington, Delaware 19805-1265 | 2,444,999 (5) | 9.7% |
| Directors and Executive Officers | | |
| Ellen S. Bartel | 15,000 | * |
| William F. Bruss | 120,354 | * |
| Thomas E. Dalum | 200,127 | * |
| Mark R. Gerke | 70,399 | * |
| Julie A. Glynn | 17,601 | * |
| Douglas S. Gordon | 606,577 | 2.4% |
| Michael L. Hansen | 266,413 | 1.1% |
| Patrick S. Lawton | 71,631 | * |
| Jeffrey R. McGuiness | 7,132 | * |
| Kristine A. Rappé | 102,318 | * |
| Stephen J. Schmidt | 145,078 | * |
| Derek L. Tyus | 6,440 | * |
| All directors and executive officers as a group (11 persons) (6) | 2,998,985 | 11.9% |

* 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 – 61,589; Mr. Dalum – 61,596; Mr. Gerke – 27,351; Ms. Glynn – 3,938; Mr. Gordon – 65,271; Mr. Hansen – 186,541; Mr. Lawton – 10,000; group – 1,786,201. Includes the following shares underlying options which are exercisable within 60 days of March 24, 2021: Dalum, Rappé and Schmidt – 75,000 shares each; Mr. Lawton – 12,500; Mr. Bruss – 30,000; Mr. Gerke – 13,000; Ms. Glynn – 12,000; all directors and executive officers as a group – 292,500.

(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 11, 2021.

(3) Based on a Schedule 13G/A filed by Dimensional Fund Advisors LP with the Securities and Exchange Commission on February 12, 2021.

(4) Based on a Schedule 13G/A filed by BlackRock, Inc. with the Securities and Exchange Commission on February 1, 2021.

(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, 2021. 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 1,369,915 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 eight 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 Douglas S. Gordon and Patrick S. Lawton, whose terms expire at the annual meeting, are being nominated for re-election as directors, each for a term expiring at the 2024 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, 2020; 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.

| Name and Age | Principal Occupation and Business Experience | Director Since [(1)] |
|---|---|---|
| | ***Nominees for terms expiring in 2024*** | |
| Douglas S. Gordon, 63 | Mr. Gordon is the Chief Executive Officer and President of Waterstone Financial and WaterStone Bank, beginning in 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, 64 | 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, 66 | Ms. Bartel is the former President of Divine Savior Holy Angels (DSHA) High School (Milwaukee, Wisconsin) from 1998 until 2018, 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 | 2013 |

| | | |
|---|---|---|
| | management and human resources matters. Ms. Bartel has a B.A. and an M.S.A. from the University of Notre Dame. | |
| Thomas E. Dalum, 80 | 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, 64 | 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 a an M.A. from Northeastern University and a B.A. from the University of Wisconsin – Oshkosh. | 2013 |
| | ***Continuing Directors - Terms expiring in 2023*** | |
| Michael L. Hansen, 69 | Mr. Hansen is a business investor who currently holds significant ownership interests in Jacsten Holdings LLC and Mid-States Contracting, Inc. In addition to 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. | 2013 |
| Stephen J. Schmidt, 59 | 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. | 1979 |
| Derek L. Tyus, 51 | Mr. Tyus currently serves as Vice President and Chief Investment Officer of West Bend Mutual Insurance Company. He has been with West Bend since 2016. Before joining West Bend, Mr. Tyus was a director for Northwestern Mutual Wealth Management Company. He has been in the insurance industry for 22 years, holding investment positions in private debt and equity, real estate, wealth management as well as strategy and administration. Mr. Tyus is a graduate of Marquette University and received his M.B.A. from the Ross School of Business at the University of Michigan. | 2021 |

**(1)** Indicates the date when the 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. Mr. Tyus became a director of Waterstone Financial in 2021.

## Executive Officers

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.

| Name and Age | Offices and Positions with Waterstone Financial and WaterStone Bank | Executive Officer Since |
|---|---|---|
| William F. Bruss, 51 | Executive Vice President since 2015, Chief Operating Officer (appointed 2013), General Counsel and Secretary, Waterstone Financial and WaterStone Bank | 2005 |
| Mark R. Gerke, 46 | 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, 57 | Chief Retail Officer of WaterStone Bank since March 2018, Senior Vice President - District Manager of Associated Bank since 2013 | 2018 |
| Jeff R. McGuiness, 55 | President and Chief Executive Officer of Waterstone Mortgage Corporation since November 2020. Prior to his role with Waterstone Mortgage Corporation, Chief Sales Officer, Embrace Home Loans – 2015 through November 2020, Chief Executive Officer, Lenders One – 2012 to 2015. | 2020 |

## Board Meetings and Committees

The board of directors of Waterstone Financial met 12 times during the year ended December 31, 2020 on behalf of Waterstone Financial and 12 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, Schmidt anfd Tyus 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. 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).

We conduct business through meetings of the Company's and Bank's boards of directors and their committees. The boards of directors of the Company and the Bank have established standing committees discussed below. The standing committees of the Company include an Audit Committee, Compensation Committee, Executive Committee and a Nominating and Corporate Governance Committee. Each of these committees operates under a written charter available on the Company's website at www.mcbankny.com.

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 Corporate 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 |
| Derek L. Tyus | X | X | X | |

**Audit Committee.** The audit committee of Waterstone Financial (the "Audit Committee") met nine times during the year ended December 31, 2020. 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 five meetings during the year ended December 31, 2020. 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 two meetings during the year ended December 31, 2020. 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, 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, 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 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, 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.

## 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, 2020 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
Derek L. Tyus

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, 2020. 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, 2020.

## PROPOSAL 2 – RATIFICATION OF THE APPOINTMENT OF OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The firm of RSM US LLP has audited the financial statements of Waterstone Financial as of and for the year ended December 31, 2020 and has served as Waterstone Financial's principal independent accountant since 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, 2021. 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 2020 and 2019 for professional services provided by RSM US LLP related to those periods.

| | **Year Ended** | |
|---|---|---|
| | **December 31, 2020** | **December 31, 2019** |
| Audit fees[(1)(2)]………… | $ 393,695 | $ 341,875 |
| Audit-related fees…….. | $ - | $ - |

(1) Audit fees consist of professional services rendered for the audit of our financial statements, review of SEC Filings and consent on Form S-8.
(2) Fees for the year ended December 31, 2019 have been adjusted for amounts that were estimated in the previously filed Proxy

**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 Polices 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 2020 annual meeting of shareholders, over 82% 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.

We have held annual say-on-pay votes since 2010 and we will hold annual say-on-pay votes until the next shareholders vote regarding the frequency of say-on-pay votes, which we expect to occur at the 2026 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 Polices**

***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 2020, 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 2020 compensation opportunities for executives. In conducting this analysis, the Committee reviewed market data using publicly disclosed compensation information from a peer group of comparable financial institutions ranging in asset size from $1.6 billion to $4.4 billion. In addition to asset size, peer group selection was also focused on banks with significant mortgage banking operations, a significant focus on real estate lending and/or banks that were recent mutual-to-stock conversions.

For 2020, 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 Chief Retail Officer:

- Bank Financial Corporation, Burr Ridge, IL
- Cambridge Bancorp, Cambridge, MA
- Civista Bancshares, Inc., Sandusky, OH
- ESSA Bancorp, Inc., Stroudsburg, PA
- Farmers & Merchants Bancorp, Inc., Archbold, OH
- FS Bancorp, Inc., Mountlake Terrance, WA
- Greene 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
- Metropolitan Bank Holding Corporation, New York, NY
- MVB Financial Corp., Fairmont, WV
- RBB Bancorp, Los Angeles, CA
- Sterling Bancorp, Inc., Southfield, MI
- Territorial Bancorp Inc., Honolulu, HI

***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 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, 2020, all directors were in compliance with the Company's stock ownership guidelines. As of December 31, 2020, all Named Executive Officers that have been employed with the Company for at least five years were 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 a Named Executive Officer, to the extent such payments and grants were made to the Named Executive Officer 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 2020 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 2020 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 2020, 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.

| Name and Principal Position | 2020 ($) | 2019 ($) | Change ($) | Change (%) |
|---|---|---|---|---|
| **Douglas S. Gordon**<br>Chief Executive Officer of Waterstone Financial and WaterStone Bank | 850,000 | 850,000 | — | — |
| **William F. Bruss**<br>Chief Operating Officer and General Counsel of Waterstone Financial and WaterStone Bank | 365,000 | 318,000 | 47,000 | 14.8% |
| **Mark R. Gerke**<br>Chief Financial Officer of Waterstone Financial and WaterStone Bank | 250,000 | 206,000 | 44,000 | 21.4% |
| **Julie A. Glynn**<br>Chief Retail Officer of WaterStone Bank | 225,000 | 190,500 | 34,500 | 18.1% |
| **Jeff McGuiness**<br>Chief Executive Officer and President of Waterstone Mortgage Corporation (1) | 400,000 | — | — | — |

(1) Mr. McGuiness was appointed Chief Executive Officer of Waterstone Mortgage Corporation on November 16, 2020.

***Annual Incentive Plan.*** We maintain an Annual Incentive Plan which provides Named Executive Officers of WaterStone Bank with annual cash incentive opportunities for annual performance. The ability to earn any award is primarily 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 did not participate in the Annual Incentive Plan during the year ended December 31, 2020, as his employment did not begin until November 16, 2020. In future years, Mr. McGuiness will 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 2020 budget. To receive any award under the Annual Incentive Plan, the named executive officer must be 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 and enhancing our franchise value through growth of our commercial loan portfolio and core deposits. The Compensation Committee determined that to encourage these goals, the Annual Incentive Plan would include the following performance measures:

| Performance Measure | Evaluated Against | Rationale |
|---|---|---|
| Earnings Per Share | Budget | Focuses management on achieving budgeted net income. |
| Commercial Loan Growth | Budget | Focuses management on enhancing franchise value through growth of the Commercial Real Estate and Commercial and Industrial segments of the loan portfolio. |
| Core Deposit Growth | Budget | 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 | | Contingent on individual achievement of strategic or operational non-financial objectives. |

**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 2020:

| | | Target | | |
|---|---|---|---|---|
| Name | Threshold ($) | Amount ($) | % of Annual Base Salary | Maximum ($) |
| **Douglas S. Gordon** | 212,500 | 425,000 | 50% | 637,500 |
| **William F. Bruss** | 91,250 | 136,875 | 37.5% | 182,500 |
| **Mark R. Gerke** | 25,000 | 37,500 | 15% | 50,000 |
| **Julie A. Glynn** | 45,000 | 67,500 | 30% | 90,000 |

**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 2020 are summarized in the following table:

| Name | Earnings Per Share | Commercial Loan Growth | Core Deposit Growth | Individual Performance |
|---|---|---|---|---|
| **Douglas S. Gordon** | 50% | 20% | 20% | 10% |
| **William F. Bruss** | 50% | 20% | 20% | 10% |
| **Mark R. Gerke** | 50% | 20% | 20% | 10% |
| **Julie A. Glynn** | 20% | 20% | 50% | 10% |

**Performance Results and Payouts**

The Committee 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. 2020 performance goals and actual performance were as follows:

| 2020 Performance Measure | Threshold | Target | Maximum | Actual | Achievement as a % of Target |
|---|---|---|---|---|---|
| **Earnings Per Share** | $0.96 | $1.06 | $1.27 | $3.30 | 311% |
| **Commercial Loan Growth** | 1.10% | 2.20% | 4.00% | 1.37% | 62% |
| **Core Deposit Growth** | 3.00% | 4.50% | 7.00% | 45.41% | 712% |

Based upon the above financial performance measures and the Committee's discretion with respect to individual performance, the 2020 annual cash incentive payments were awarded as follows relative to the 2020 target value:

| Name | 2020 Annual Incentive Payment ($) | % of 2020 Target Annual Incentive |
|---|---|---|
| **Douglas S. Gordon** | 562,932 | 132.5% |
| **William F. Bruss** | 166,490 | 121.6% |
| **Mark R. Gerke** | 45,614 | 121.6% |
| **Julie A. Glynn** | 82,105 | 121.6% |

***Equity-Based Compensation***. The overall objective for our equity-based compensation is to provide an equitable and competitive means to reward our officers for their contributions to our long-range success. Our goal is to meet the following objectives:

- Align the interests of our officers with the interests of shareholders by linking the long-term value of the compensation to shareholder returns
- Link each participant's compensation to our long-term success through the appreciation of the stock price

- 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 granted 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 recent years, we have utilized restricted stock as our primary long-term incentive tool to retain and motivate our key employees. We believe this is an excellent way to reward them for, and to motivate them toward, superior performance. Restricted stock is an important retention instrument in that it has immediate value to the recipient In 2018, 20,000 incentive stock option awards were granted to the Chief Retail Officer. No new awards of restricted stock were granted to any of the Named Executive Officers during 2020. 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 vested in five installments over four 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.

***2021 Performance-Based Equity Compensation***

During 2021, our Compensation Committee determined that grants of performance-based restricted stock would be made to our executive officers. In order to become vested in their restricted stock, our executive officers will need to be employed throughout the three-year performance period of 2021 to 2023, which satisfies a retention goal, and the Company must meet certain pre-determined financial performance goals. The Compensation Committee believes it is important for the restricted stock, which is intended to be a long-term incentive, to focus our executive officers on, and reward them for, the achievement of multi-year performance objectives. The performance goals will be set at a target performance level. If the Company meets the target performance level, the executive officers would be vested in the number of shares designated as the "target award." Performance levels would also be set at a maximum level to provide an incentive for superior performance, and at a threshold level, below which no shares would be earned. Depending on the Company's performance relative to the performance goals, the executive officers could earn between 0% and 150% of the target award. For the performance period of 2021 to 2023, our Compensation Committee will set the target number of shares by reference to the 2021 base salary of each executive officer

***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 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
Derek L. Tyus

## PROPOSAL 3– 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 2021 Annual Meeting of Shareholders pursuant to Item 402 Securities and Exchange Commission Regulation S-K, including the Compensation Discussion and Analysis, the 2020 compensation tables and narrative discussion is hereby approved.

We will hold annual say-on-pay votes until the next shareholders vote regarding the frequency of say-on-pay votes, which we expect to occur at the 2026 annual meeting of shareholders.

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 3.**

## 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, 2020. 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 ($) | Option Awards ($)(1) | All Other Compensation ($)(2) | Total ($) |
|---|---|---|---|---|---|---|---|
| **Douglas S. Gordon** | 2020 | 850,000 | 562,932 | — | — | 63,026 | 1,475,958 |
| Chief Executive Officer of | 2019 | 850,000 | 181,688 | — | — | 187,986 | 1,219,674 |
| Waterstone Financial and | 2018 | 850,000 | — | — | — | 137,899 | 987,899 |
| WaterStone Bank | | | | | | | |
| **William F. Bruss** | 2020 | 357,000 | 166,490 | — | — | 67,847 | 591,337 |
| Chief Operating Officer and | 2019 | 318,000 | 67,973 | — | — | 86,911 | 472,884 |
| General Counsel of | 2018 | 308,654 | — | — | — | 74,343 | 382,997 |
| Waterstone Financial and WaterStone Bank | | | | | | | |
| **Mark R. Gerke** | 2020 | 242,000 | 45,614 | — | — | 72,667 | 360,281 |
| Chief Financial Officer of | 2019 | 206,000 | 44,033 | — | — | 61,353 | 311,386 |
| Waterstone Financial and | 2018 | 197,308 | — | — | — | 56,949 | 254,257 |
| WaterStone Bank | | | | | | | |
| **Julie A. Glynn** | 2020 | 219,000 | 82,105 | — | — | 57,996 | 359,101 |
| Senior Vice President and | 2019 | 190,500 | 73,343 | — | — | 24,629 | 288,472 |
| Director of Retail of | 2018 | 132,192 | 40,000 | — | 72,800 | 4,162 | 249,154 |
| WaterStone Bank (3) | | | | | | | |
| **Jeff McGuiness** President of Waterstone Mortgage Corporation (4) | 2020 | 30,769 | 325,000 | — | — | — | 355,769 |

(1) Reflects the aggregate grant-date fair value of the option awards granted during the year 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, 2020, 2019 and 2018 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" for 2020 is provided in the table below.

(3) Ms. Glynn initiated employment with the Company on March 26, 2018.

(4) Mr. McGuiness initiated employment with the Company on November 16, 2020. The salary presented in the table reflects the amount paid of the $400,000 2020 base salary. The Employment Agreement with Mr. McGuiness provided for a cash-based sign-on bonus in the amount of $325,000, which was paid by the Company on the date of the Company's first regularly scheduled payroll of 2021. The sign-on bonus will not be earned in full until December 31, 2023.

## All Other Compensation

| Name and Principal Position | 401(k) Match ($) | Employee Stock Ownership Plan ($) | Automobile Expense Allowance ($)(2) | Restricted Stock Dividends ($)(1) | Total ($) |
|---|---|---|---|---|---|
| **Douglas S. Gordon** | 2,811 | 53,970 | 6,245 | — | 63,026 |
| **William F. Bruss** | 2,941 | 53,970 | 10,936 | — | 67,847 |
| **Mark R. Gerke** | 2,497 | 53,970 | 840 | 15,360 | 72,667 |
| **Julie A. Glynn** | 2,078 | 53,970 | 2,078 | — | 57,996 |
| **Jeff R. McGuiness** | — | — | — | — | — |

(1) Represents dividends paid on shares of restricted stock that vested during the year.

## Realized Compensation

To supplement the SEC required disclosure in the above Summary Compensation Table, the following additional table has been included to show the total compensation realized by each Named Executive Officer in each of the years shown. The Company believes that this table is useful to shareholders as it believes that is reflects the compensation actually realized by the Named Executive Officers. The Summary Compensation Table, as calculated under the SEC rules, includes items that are impacted by accounting assumptions and also may include amounts that are not ultimately realized, and therefore that table may not necessarily be reflective of realized compensation in a particular year.

The table below shows compensation realized by each Named Executive Officer. For purposes of this presentation, realized compensation includes, base salary, performance-based cash bonus and all other compensation, all of which are included in the SEC required disclosure in the above Summary Compensation Table. To approximate an amount that represents realized compensation, the following table also includes an amount that represents the value realized upon the vesting of restricted stock awards and omits the grant date fair value of stock or option awards that have not vested.

| REALIZED COMPENSATION | | | | | | |
|---|---|---|---|---|---|---|
| **Name and Principal Position** | **Year** | **Salary ($)** | **Bonus ($)** | **Value Realized on Stock Awards Vesting ($)** | **All Other Compensation ($)** | **Total ($)** |
| **Douglas S. Gordon**<br>Chief Executive Officer of Waterstone Financial and WaterStone Bank | 2020<br>2019<br>2018 | 850,000<br>850,000<br>850,000 | 562,932<br>181,688<br>— | —<br>839,500<br>885,000 | 63,026<br>187,986<br>137,899 | 1,475,958<br>2,059,174<br>1,872,899 |
| **William F. Bruss**<br>Chief Operating Officer and General Counsel of Waterstone Financial and WaterStone Bank | 2020<br>2019<br>2018 | 357,000<br>318,000<br>308,654 | 166,490<br>67,973<br>— | —<br>100,740<br>106,200 | 67,847<br>86,911<br>74,343 | 591,337<br>573,624<br>489,197 |
| **Mark R. Gerke**<br>Chief Financial Officer of Waterstone Financial and WaterStone Bank | 2020<br>2019<br>2018 | 242,000<br>206,000<br>197,308 | 45,614<br>44,033<br>— | 59,720<br>67,640<br>71,600 | 72,667<br>61,353<br>56,949 | 420,001<br>379,026<br>325,857 |
| **Julie A. Glynn**<br>Senior Vice President and Director of Retail of WaterStone Bank | 2020<br>2019<br>2018 | 219,000<br>190,500<br>132,192 | 82,105<br>73,343<br>40,000 | —<br>—<br>— | 57,996<br>24,629<br>4,162 | 359,101<br>288,472<br>176,354 |
| **Jeff R. McGuiness**<br>President of Waterstone Mortgage Corporation | 2020 | 30,769 | — | — | — | 30,769 |

**Employment Agreements**

***Employment Agreement with Douglas S. Gordon.*** WaterStone Bank has entered into an employment agreement with Douglas S. Gordon, its President and Chief Executive Officer. Commencing on January 1, 2015 (the "Anniversary Date") and continuing each January 1st 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 2021 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. 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. 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 Jeffrey McGuiness.*** Effective as of November 16, 2020, Waterstone Mortgage Corporation entered into an employment agreement with its President and Chief Executive Officer, Jeffrey McGuiness. The agreement has an initial term continuing through December 31, 2023. Thereafter, the agreement shall renew for successive on 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. McGuiness is entitled to a base salary in 2021 of $400,000 and participation in company-wide employee benefits, including Waterstone Mortgage Corporation's 401(k) Plan. Mr. McGuiness is also entitled to annual cash-based performance bonus compensation beginning in 2021. Mr. McGuiness was granted shares of restricted stock in January 2021 with a value of $135,000 on the date of grant. The shares will vest on the third anniversary of the grant date. Mr. McGuiness was eligible for a cash-based sign-on bonus in the amount of $325,000, which was paid by the Company on the date of the Company's first regularly scheduled payroll of 2021. The sign-on bonus will not be earned in full until December 31, 2023.

Mr. McGuiness may 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. McGuiness's employment for any reason other than "good cause," Mr. McGuiness will be entitled to receive his earned but unpaid base salary as of the date of his termination with the Company, the vested benefits, if any, to which he is entitled as a former employee under the employee benefit plans and a payment equal to one year's base salary, subject to the terms of the agreement and shall accelerate or cause to be accelerated the vesting of the restricted stock award. In the event of Mr. McGuiness's death during the term of the Agreement, the Agreement will terminate with no payment of severance compensation to Mr. McGuiness's estate. Similarly, in the event of his termination by the Company for good cause, Mr. McGuiness will not be entitled to any severance compensation.

In the event of Mr. McGuiness'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 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, Chief Retail Officer. 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. 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, 2020. Grants were made under our 2015 Equity Incentive Plans.

| OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2020 | | | | | | |
|---|---|---|---|---|---|---|
| | Option Awards | | | | Stock Awards | |
| Name | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Option Exercise Price ($) | Option Expiration Date | Number of Shares or Units of Stock That Have Not Vested (#) | Market Value of Shares or Units of Stock That Have Not Vested ($) |
| William F. Bruss | 30,000 | — | 12.75 | 3/4/2025 | — | — |
| Mark R. Gerke | 10,000 | — | 12.75 | 3/4/2025 | — | — |
| | 8,000 | 2,000 (1) | 14.98 | 6/21/2026 | — | — |
| Julie A. Glynn | 12,000 | 8,000 (1) | 17.35 | 3/20/2028 | — | — |

(1) 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, 2020.

| OPTION EXERCISES AND STOCK VESTED DURING THE YEAR ENDED DECEMBER 31, 2020 | | | | |
|---|---|---|---|---|
| | Option Awards | | Stock Awards | |
| Name | Number of Shares Acquired on Exercise (#) | Value Realized on Exercise ($) | Number of Shares Acquired on Vesting(#) | Value Realized on Vesting ($) |
| Douglas S. Gordon | 118,628 | 142,896 | — | — |
| Mark R. Gerke | 3,292 | 51,487 | 4,000 | 58,720 (1) |

(1) Based on the $14.68 per share closing price of our common stock on June 22, 2020.

## 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, 2020, 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.

| | POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE IN CONTROL | | | | |
|---|---|---|---|---|---|
| | Mr. Gordon | Mr. Bruss | Mr. Gerke | Ms. Glynn | Mr. McGuiness |
| **Discharge Without Cause or Resignation With Good Reason — no Change in Control** | | | | | |
| Severance payment | $ 3,739,551 (1) | $ — | $ — | $ — | $ 400,000 (1) |
| Medical, dental and life insurance benefits | 36,344 (2) | — | — | — | — |
| Acceleration of vesting of stock options | — | — | — | — | — |
| Total | $ 3,775,896 | $ — | $ — | $ — | $ 400,000 |
| **Discharge Without Cause or Resignation With Good Reason — Change in Control Related** | | | | | |
| Severance payment (lump sum) | $ 6,141,471 (3) | $ — | $ — | $ 225,000 (3) | $ 400,000 (3) |
| Medical, dental and life insurance benefits | 54,516 (2) | — | — | — | — |
| Acceleration of vesting of stock options | — | — | 7,680 (4) | 17,640 (4) | — |
| Acceleration of vesting of restricted stock | — | — | — | — | — |
| Total | $ 6,391,653 | $ — | $ 7,680 | $ 242,640 | $ 400,000 |
| **Disability** | | | | | |
| Severance/disability payment | $ 1,416,667 (5) | $ — | $ — | $ — | $ — |
| Acceleration of vesting of stock option | — | — | 7,680 (4) | 17,640 (4) | — |
| Acceleration of vesting of restricted stock | — | — | — | — | — |
| Total | $ 1,416,667 | $ — | $ 7,680 | $ 17,640 | $ — |
| **Death** | | | | | |
| Salary continuation payment | $ 850,000 (6) | $ — | $ — | $ 225,000 (6) | $ — |
| Medical, dental and life insurance benefits | 18,172 (6) | — | — | — | — |
| Acceleration of vesting of stock options | — | — | 7,680 (4) | 17,640 (4) | — |
| Acceleration of vesting of restricted stock | — | — | — | — | — |
| Total | $ 868,172 | $ — | $ 7,680 | $ 242,640 | $ — |

(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. McGuiness'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. McGuiness, 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.

(4) Value is based on the closing price of $18.82 on December 31, 2020 of Waterstone Financial, Inc. common stock less the exercise price of the stock option.

(5) 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.)

(6) 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 the 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 2020:

- The median of the annual total compensation of all employees of our company (other than our Chief Executive Officer), was $82,138; and
- The annual total compensation of Mr. Gordon, our President and Chief Executive Officer was $1,473,801.

Based on this information, the ratio for 2020 of the annual total compensation of our President and Chief Executive Officer to the median of the annual total compensation of all employees is 17.9 to 1.

We completed the following steps to identify the median employee:

- As of December 31 2020, our employee population consisted of approximately 828 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 2020. In making this determination, we annualized compensation for full-time and part-time permanent employees who were employed on December 31, 2020, 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, 2020. Compensation includes an annual retainer as well as chairmanship and committee fees.

| DIRECTOR COMPENSATION TABLE FOR THE YEAR ENDED DECEMBER 31, 2020 | | |
|---|---|---|
| **Name** | **Fees earned or paid in cash ($)** | **Total ($)** |
| Ellen S. Bartel<br>Nominating Committee Co-chairman | 18,000 | 18,000 |
| Thomas E. Dalum<br>Compensation Committee Chairman | 18,000 | 18,000 |
| Michael L. Hansen<br>Audit Committee Chairman | 24,000 | 24,000 |
| Patrick S. Lawton<br>Chairman of the Board | 30,000 | 30,000 |
| Kristine A. Rappé<br>Executive Committee Chairman | 18,000 | 18,000 |
| Stephen J. Schmidt<br>Nominating Committee Co-chairman | 18,000 | 18,000 |

In 2020, 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, 2020, Mr. Lawton had 10,000 unvested shares of restricted stock, Mr. Hansen had 8,000 unvested shares of restricted stock, and Ms. Bartel, Mr. Dalum, Ms. Rappé, and Mr. Schmidt had 7,000 unvested shares of restricted stock, respectively. Mr. Dalum, Mr. Hansen, Ms. Rappé, and Mr. Schmidt had 75,000 vested but unexercised stock options and 25,000 unvested stock options, respectively. Ms. Bartel and Mr. Lawton had 25,000 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 Rappé filed a late form 4 to report a sale of common stock. 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, 2020.

## 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.

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, 2020, 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.

## SOCIAL AND ENVIRONMENTAL COMMITMENT

Management and the Board of Directors of Waterstone Financial, Inc. recognize that environmental and social matters impact WaterSone 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 570 hours for community organizations in 2020.
- Bank employees have leadership roles with over 50 community organizations.
- The WaterStone Bank Foundation awarded more than $750,000 in grants to more than 240 community organizations during 2020.

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 9, 2021 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 22, 2022 in the case of the 2022 annual meeting of shareholders. Waterstone Financial is not aware of any such proposals for the 2021 annual meeting.

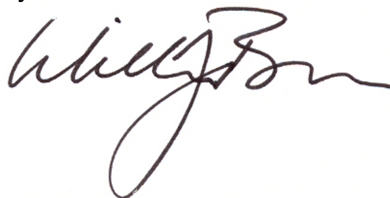
Our Bylaws provide an advance notice procedure for certain business, or nominations to the board of directors, to be brought before an annual meeting of shareholders. In order for a stockholder to properly bring business before an annual meeting, or to propose a nominee to the board of directors, our 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 17, 2022. Assuming the next Annual Meeting of Shareholders is held on May 17, 2022, 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 16, 2022 and no later than February 26, 2022. If notice is received before February 16, 2022 or after February 26, 2022, 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 8, 2021

**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, 2020 (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.**

**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, 2020

Commission file number: 001-36271

# WATERSTONE FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

| **Maryland** | **90-1026709** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **11200 W Plank Ct, Wauwatosa, Wisconsin** | **53226** |
| (Address of principal executive offices) | (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. o

Indicate by check mark whether the registrant has filed a report on and attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

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, 2020 as reported by the NASDAQ Global Select Market®, was approximately $383.3 million.

As of February 26, 2021, 25,117,634 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 18, 2021 | Part III |

**WATERSTONE FINANCIAL, INC.**

**FORM 10-K ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION**
**FOR THE YEAR ENDED DECEMBER 31, 2020**

**TABLE OF CONTENTS**


| ITEM | | PAGE |
|---|---|---|
| **PART I** | | |
| 1. | Business | 3-29 |
| 1A. | Risk Factors | 29-37 |
| 1B. | Unresolved Staff Comments | 37 |
| 2. | Properties | 38 |
| 3. | Legal Proceedings | 38 |
| 4. | Mine Safety Disclosures | 38 |
| **PART II** | | |
| 5. | Market for Registrant's Common Equity, Related Stockholders Matters and Issuer Purchases of Equity Securities | 39-40 |
| 6. | Selected Financial Data | 41-42 |
| 7. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 42-54 |
| 7A. | Quantitative and Qualitative Disclosures About Market Risk | 55 |
| 8. | Financial Statements and Supplementary Data | 56-97 |
| 9. | Changes in and Disagreements with Accountants on Accounting and Financial Disclosure | 98 |
| 9A. | Controls and Procedures | 98-99 |
| 9B. | Other Information | 100 |
| **PART III** | | |
| 10. | Directors, Executive Officers and Corporate Governance | 100 |
| 11. | Executive Compensation | 100 |
| 12. | Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 100 |
| 13. | Certain Relationships and Related Transactions, and Director Independence | 101 |
| 14. | Principal Accountant Fees and Services | 101 |
| **PART IV** | | |
| 15. | Exhibits and Financial Statement Schedules | 101-103 |
| 16. | Form 10-K Summary | 102 |
| | Signatures | 103-104 |

## PART 1

## 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;
- the effect of any pandemic; including COVID-19;
- 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;
- 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. 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 59 offices in 22 states as of December 31, 2020.

WaterStone Bank conducts its community banking business from 14 banking offices located in Milwaukee, Washington and Waukesha counties, Wisconsin. 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, 2020, such loans comprised 31.0%, 41.6%, and 17.3%, 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, private-label 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. 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 $4.33 billion in mortgage loans held for sale during the year ended December 31, 2020, 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 2006, Waterstone Mortgage Corporation is a mortgage banking business with offices in 22 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 nine branch offices in Milwaukee County, four branch offices in Waukesha County and one branch office in Washington County. At June 30, 2020 (the latest date for which information was publicly available), 47.7% of deposits in the State of Wisconsin were located in the seven-county Milwaukee metropolitan market and 40.9% 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.

***Waterstone Mortgage Corporation.*** As of December 31, 2020, Waterstone Mortgage Corporation had nine offices in Wisconsin, eight offices in each of Florida and New Mexico, four offices in Minnesota, three offices in each of Illinois and Texas, two offices in each of Arizona, Colorado, Idaho, Maryland, Ohio, Oklahoma, Oregon, and Virginia, and one office in each of Arkansas, California, Georgia, Iowa, Michigan, New Hampshire, Pennsylvania, and Tennessee.

**Competition**

***WaterStone Bank.*** WaterStone Bank faces competition within our market area both in making real estate loans and attracting deposits. The Milwaukee-Waukesha metropolitan statistical area has a high concentration of financial institutions, including large commercial banks, community banks and credit unions. As of June 30, 2020, based on the FDIC annual Summary of Deposits Report, we had the ninth largest market share in our metropolitan statistical area out of 48 financial institutions, representing 1.57% 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 $426.8 million, or 31.0%, of our total loan portfolio at December 31, 2020. Multi-family residential mortgage loans represented $571.9 million, or 41.6%, of our total loan portfolio at December 31, 2020. Commercial real estate loans represented $238.4 million, or 17.3%, of our total loan portfolio at December 31, 2020. We also offer construction and land loans, home equity lines of credit and commercial loans. At December 31, 2020, commercial business loans, home equity loans, and land and construction loans totaled $45.4 million, $14.8 million and $77.1 million, respectively.

The largest exposure to one borrower or group of related borrowers was $40.7 million in the multi-family category. The borrower represented a total of 3.0% of the total loan portfolio as of December 31, 2020.

***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, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2020 | | 2019 | | 2018 | | 2017 | | 2016 | |
| | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent | Amount | Percent |
| | (Dollars in Thousands) | | | | | | | | | |
| Mortgage loans: | | | | | | | | | | |
| Residential real estate: | | | | | | | | | | |
| One- to four-family | $ 426,792 | 31.04% | $ 480,280 | 34.60% | $ 489,979 | 35.53% | $ 439,597 | 34.03% | $ 392,817 | 33.35% |
| Multi-family | 571,948 | 41.59% | 584,859 | 42.14% | 597,087 | 43.29% | 578,440 | 44.77% | 558,592 | 47.42% |
| Home equity | 14,820 | 1.08% | 18,071 | 1.30% | 19,956 | 1.45% | 21,124 | 1.64% | 21,778 | 1.85% |
| Construction and land | 77,080 | 5.61% | 37,033 | 2.67% | 13,361 | 0.97% | 19,859 | 1.54% | 18,179 | 1.54% |
| Commercial real estate | 238,375 | 17.33% | 236,703 | 17.05% | 225,522 | 16.35% | 195,842 | 15.16% | 159,401 | 13.53% |
| Commercial loans | 45,386 | 3.30% | 30,253 | 2.18% | 32,810 | 2.38% | 36,697 | 2.84% | 26,798 | 2.28% |
| Consumer | 736 | 0.05% | 832 | 0.06% | 433 | 0.03% | 255 | 0.02% | 319 | 0.03% |
| Total loans | 1,375,137 | 100.00% | 1,388,031 | 100.00% | 1,379,148 | 100.00% | 1,291,814 | 100.00% | 1,177,884 | 100.00% |
| Allowance for loan losses | (18,823) | | (12,387) | | (13,249) | | (14,077) | | (16,029) | |
| Loans, net | $ 1,356,314 | | $ 1,375,644 | | $ 1,365,899 | | $ 1,277,737 | | $ 1,161,855 | |

***Loan Portfolio Maturities and Yields.*** The following table summarizes the final maturities of our loan portfolio at December 31, 2020. Maturities are based upon the final contractual payment dates and do not reflect the impact of prepayments and scheduled monthly payments that will occur.

| Maturing in the year ended December 31, | One- to four-family Amount | One- to four-family Weighted Average Rate | Multi-family Amount | Multi-family Weighted Average Rate | Home Equity Amount | Home Equity Weighted Average Rate | Construction and Land Amount | Construction and Land Weighted Average Rate |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in Thousands) | | | | | | | |
| One year or less | $ 12,970 | 3.38% | $ 24,263 | 4.08% | $ 1,517 | 5.08% | $ 12,934 | 4.04% |
| More than one year through five years | 53,608 | 4.80% | 271,561 | 4.17% | 6,933 | 4.85% | 49,825 | 3.02% |
| More than five years through 15 years | 89,869 | 4.75% | 271,756 | 3.65% | 6,328 | 4.35% | 14,278 | 4.48% |
| More than 15 years | 270,345 | 4.22% | 4,368 | 4.37% | 42 | 4.76% | 43 | 2.33% |
| Total | $ 426,792 | 4.38% | $ 571,948 | 3.92% | $ 14,820 | 4.66% | $ 77,080 | 3.46% |

| Maturing the year ended December 31, | Commercial Real Estate Amount | Commercial Real Estate Weighted Average Rate | Commercial Amount | Commercial Weighted Average Rate | Consumer Amount | Consumer Weighted Average Rate | Total Amount | Total Weighted Average Rate |
|---|---|---|---|---|---|---|---|---|
| | (Dollars in Thousands) | | | | | | | |
| One year or less | $ 17,597 | 4.11% | $ 6,602 | 4.38% | $ 723 | 7.22% | $ 76,606 | 4.04% |
| More than one year through five years | 141,366 | 4.24% | 29,333 | 2.16% | 13 | 7.69% | 552,639 | 4.05% |
| More than five years through 15 years | 79,237 | 3.80% | 3,372 | 4.33% | - | 0.00% | 464,840 | 3.93% |
| More than 15 years | 175 | 5.71% | 6,079 | 6.74% | - | 0.00% | 281,052 | 4.28% |
| Total | $ 238,375 | 4.09% | $ 45,386 | 3.26% | $ 736 | 7.23% | $ 1,375,137 | 4.05% |

The following table sets forth the scheduled repayments of fixed and adjustable rate loans at December 31, 2020 that are contractually due after December 31, 2021.

| | Due After December 31, 2021 Fixed | Adjustable | Total |
|---|---|---|---|
| | (In Thousands) | | |
| Mortgage loans | | | |
| Real estate loans: | | | |
| One- to four-family | $ 22,918 | $ 390,904 | $ 413,822 |
| Multi-family | 209,191 | 338,494 | 547,685 |
| Home equity | 2,872 | 10,431 | 13,303 |
| Construction and land | 20,462 | 43,684 | 64,146 |
| Commercial | 140,360 | 80,418 | 220,778 |
| Commercial | 32,818 | 5,966 | 38,784 |
| Consumer | 13 | - | 13 |
| Total loans | $ 428,634 | $ 869,897 | $ 1,298,531 |

***One- to Four-Family Residential Mortgage Loans.*** One- to four-family residential mortgage loans totaled $426.8 million, or 31.0% of total loans at December 31, 2020. 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.

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 $231,000 on December 31, 2020, and the largest outstanding balance on that date was $6.2 million, which is a consolidation loan that is collateralized by 86 single family properties. A total of 52.3% 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 $571.9 million, or 41.6% of total loans at December 31, 2020. 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 most 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 $1.0 million on December 31, 2020, with the largest outstanding balance at $11.8 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, 2020, outstanding home equity loans and equity lines of credit totaled $14.8 million, or 1.1% of total loans outstanding. At December 31, 2020, the unadvanced portion of home equity lines of credit totaled $13.7 million. 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 seven 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 $43,000 at December 31, 2020, with the largest outstanding balance at that date of $334,000.

***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, 2020, construction and land loans totaled $77.1 million, or 5.6% of total loans. A total of $74.2 million had yet to be advanced as of December 31, 2020.

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 three years for multi-family residences and commercial buildings. At the end of the construction phase, the construction loan converts to a longer-term mortgage loan upon stabilization. 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 $2.9 million on December 31, 2020, with the largest outstanding balance at $17.9 million. The average outstanding land loan balance was approximately $303,000 on December 31, 2020, and the largest outstanding balance on that date was $1.8 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 $238.4 million at December 31, 2020, or 17.3% 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. 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 20 to 25-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, 2020 was approximately $899,000, and the largest outstanding balance at that date was $13.0 million.

***Commercial Loans.*** Commercial loans totaled $45.4 million at December 31, 2020, or 3.3% of total loans, and are made up of loans secured by accounts receivable, inventory, equipment and real estate. Included in commercial loans are the Paycheck Protection Program (PPP) loans, which totaled $18.1 million at December 31, 2020.

As a qualified SBA lender, we were automatically authorized to originate PPP loans. The Company is actively participating in assisting our customers with applications for resources through the program. PPP loans have: (a) an interest rate of 1.0%, (b) a five-year loan term to maturity for loans made on or after June 5, 2020 (loans made prior to June 5, 2020 have a two-year term, however borrowers and lenders may mutually agree to extend the maturity for such loans to five years); and (c) principal and interest payments deferred for six months from the date of disbursement. The SBA will guarantee 100% of the PPP loans made to eligible borrowers. The entire principal amount of the borrower's PPP loan, including any accrued interest, is eligible to be reduced by the loan forgiveness amount under the PPP.

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, 2020, the unadvanced portion of working capital lines of credit totaled $19.2 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. Excluding the PPP loan balance, the average outstanding commercial loan at December 31, 2020 was $268,000 and the largest outstanding balance on that date was $6.1 million.

***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, 2020, 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:

- Any secured 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 the Chief Credit Officer or select lending personnel.

- Any secured mortgage loan up to $1.0 million can be approved jointly the Chief Executive Officer and Chief Lending Officer.

- 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 up to $250,000 for a borrower with total outstanding loans from us of less than $250,000 that is independently underwritten can be approved by select lending personnel.

- Any non-real estate loan up to $500,000 for a borrower with total outstanding loans from us of less than $500,000 that is independently underwritten can be approved by the Chief Executive Officer, Chief Lending Officer or Business Banking Manager.

- 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, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| | (Dollars in Thousands) | | | | |
| Non-accrual loans: | | | | | |
| Residential | | | | | |
| One- to four-family | $ 5,072 | $ 5,985 | $ 4,902 | $ 4,677 | $ 7,623 |
| Multi-family | 341 | 667 | 1,309 | 1,007 | 1,427 |
| Home equity | 63 | 70 | 201 | 107 | 344 |
| Construction and land | 43 | - | - | - | - |
| Commercial real estate | 41 | 303 | 125 | 251 | 422 |
| Commercial | - | - | 18 | 26 | 41 |
| Consumer | - | - | - | - | - |
| Total non-accrual loans | 5,560 | 7,025 | 6,555 | 6,068 | 9,857 |
| Real estate owned | | | | | |
| One- to four-family | - | 46 | 163 | 1,330 | 2,141 |
| Multi-family | - | - | - | - | - |
| Construction and land | 322 | 1,256 | 3,327 | 4,582 | 5,082 |
| Commercial real estate | - | - | 300 | 300 | 300 |
| Total real estate owned | 322 | 1,302 | 3,790 | 6,212 | 7,523 |
| Valuation allowance at end of period | - | (554) | (1,638) | (1,654) | (1,405) |
| Total real estate owned, net | 322 | 748 | 2,152 | 4,558 | 6,118 |
| Total non-performing assets | $ 5,882 | $ 7,773 | $ 8,707 | $ 10,626 | $ 15,975 |
| Total non-accrual loans to total loans, net | 0.40% | 0.51% | 0.48% | 0.47% | 0.84% |
| Total non-accrual loans to total assets | 0.25% | 0.35% | 0.34% | 0.34% | 0.55% |
| Total non-performing assets to total assets | 0.27% | 0.39% | 0.45% | 0.59% | 0.89% |

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, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| | (Dollars in Thousands) | | | | |
| Balance at beginning of year | $ 7,025 | $ 6,555 | $ 6,068 | $ 9,857 | $ 17,604 |
| Additions | 3,356 | 3,716 | 3,147 | 3,149 | 3,114 |
| Transfers to real estate owned | (637) | (1,052) | (545) | (2,171) | (4,590) |
| Charge-offs | (11) | (31) | (6) | (766) | (667) |
| Returned to accrual status | (2,501) | (650) | (777) | (2,716) | (4,183) |
| Principal paydowns | (1,672) | (1,513) | (1,332) | (1,285) | (1,421) |
| Balance at end of year | $ 5,560 | $ 7,025 | $ 6,555 | $ 6,068 | $ 9,857 |

Total non-accrual loans decreased by $1.5 million, or 20.9%, to $5.6 million as of December 31, 2020 compared to $7.0 million as of December 31, 2019. The ratio of non-accrual loans to total loans receivable was 0.40% at December 31, 2020 compared to 0.51% at December 31, 2019. During the year ended December 31, 2020, $637,000 was transferred to real estate owned, $11,000 in loan principal was charged off, $1.7 million in principal payments were received and $2.5 million in loans were returned to accrual status. Offsetting this activity, $3.4 million in loans were placed on non-accrual status during the year ended December 31, 2020.

Of the $5.6 million in total non-accrual loans as of December 31, 2020, $4.5 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 $214,000 in partial charge-offs have been recorded with respect to these loans as of December 31, 2020. 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 $23,000 have been recorded as of December 31, 2020. The remaining $1.1 million of non-accrual loans were reviewed on an aggregate basis and $216,000 in general valuation allowance was deemed necessary related to those loans as of December 31, 2020. The $216,000 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, 2020 totaled $2.4 million, which represents 43.8% 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, 2020.

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 was one accruing loan with a balance of $586,000 past due 90 days or more during the years ended December 31, 2020. The Company believed the loan was well collateralized and full collection of principal and interest was expected. There were no accruing loans past due 90 days or more during the years ended December 31, 2019 or 2018.

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

| | At December 31, | | | | |
|---|---|---|---|---|---|
| | **2020** | **2019** | **2018** | **2017** | **2016** |
| | (Dollars in Thousands) | | | | |
| Troubled debt restructurings | | | | | |
| Substandard | $ 9,249 | $ 4,018 | $ 4,256 | $ 5,035 | $ 7,025 |
| Watch | 2,320 | - | 2,476 | 47 | 3,112 |
| Total troubled debt restructurings | $ 11,569 | $ 4,018 | $ 6,732 | $ 5,082 | $ 10,137 |

Troubled debt restructurings totaled $11.6 million at December 31, 2020, compared to $4.0 million at December 31, 2019. At December 31, 2020, all of the troubled debt restructurings 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. Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, loans less than 30 days past due as of December 31, 2019 and COVID-19 modifications are considered current. A financial institution suspended the requirements under accounting principles generally accepted in the United States (US GAAP) for loan modifications related to COVID-19 that would otherwise be categorized as a troubled debt restructuring ("TDR"). This includes a suspension of the requirement to determine impairment of these modifications for accounting purposes. In keeping with regulatory guidance to work with borrowers during this unprecedented situation, the Company has executed a payment deferral program for our lending clients that are adversely affected by the pandemic. As of December 31, 2020, the Company had modified a total of $1.2 million consisting of principal or principal and interest. The $1.2 million in deferrals are not considered troubled debt restructurings.

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, | | | |
|---|---|---|---|---|
| | 2020 | | 2019 | |
| | Accruing | Non-accruing | Accruing | Non-accruing |
| | (In Thousands) | | | |
| One- to four-family | $ 2,733 | $ 532 | $ 2,740 | $ 685 |
| Multi-family | - | - | - | 308 |
| Commercial real estate | 7,207 | - | 278 | 7 |
| Commercial | 1,097 | - | - | - |
| | $ 11,037 | $ 532 | $ 3,018 | $ 1,000 |

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

| | At or for the Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2020 | | 2019 | |
| | Accruing | Non-accruing | Accruing | Non-accruing |
| | (In Thousands) | | | |
| Balance at beginning of year | $ 3,018 | $ 1,000 | $ 5,499 | $ 1,233 |
| Additions | 8,032 | - | - | - |
| Change in accrual status | - | - | - | - |
| Charge-offs | - | - | - | - |
| Returned to contractual/market terms | - | (318) | - | - |
| Transferred to real estate owned | - | - | - | - |
| Principal paydowns | (13) | (150) | (2,481) | (233) |
| Balance at end of period | $ 11,037 | $ 532 | $ 3,018 | $ 1,000 |

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, | |
|---|---|---|
| | 2020 | 2019 |
| | (Dollars in Thousands) | |
| Loans past due less than 90 days | $ 3,938 | $ 1,833 |
| Loans past due 90 days or more | 3,958 | 4,632 |
| Total loans past due | $ 7,896 | $ 6,465 |
| Total loans past due to total loans receivable | 0.57% | 0.47% |

Past due loans increased by $1.4 million, or 22.1%, to $7.9 million at December 31, 2020 from $6.5 million at December 31, 2019. Loans past due less than 90 days increased by $2.1 million during the year ended December 31, 2020. The increase was primarily due to a $2.1 million increase in one- to four-family loans during the year ended December 31, 2020. Loans past due 90 days or more decreased $674,000. The decrease in loans past due 90 days or more was primarily due to a decrease in the one-to four-family loans of $439,000 during the year ended December 31, 2020.

***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, 2020 and 2019 were $9.6 million and $4.0 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 $426,000 to $322,000 at December 31, 2020, compared to $748,000 at December 31, 2019. During the year ended December 31, 2020, $637,000 was transferred from loans to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled $1.1 million. There were no write-downs during the year ended December 31, 2020.

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 two properties at December 31, 2020, compared to five properties as of December 31, 2019 and 12 properties at December 31, 2018. 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.

| | At or for the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| | (Dollars in Thousands) | | | | |
| Balance at beginning of year | $ 12,387 | $ 13,249 | $ 14,077 | $ 16,029 | $ 16,185 |
| Provision (credit) for loan losses | 6,340 | (900) | (1,060) | (1,166) | 380 |
| Charge-offs: | | | | | |
| Mortgage loans | | | | | |
| One- to four-family | 82 | 125 | 69 | 1,364 | 1,003 |
| Multi-family | 5 | 3 | 14 | 92 | 489 |
| Home equity | 13 | 44 | 1 | - | 112 |
| Construction and land | 8 | - | - | 14 | 3 |
| Commercial real estate | - | 2 | - | 7 | - |
| Consumer | 10 | 5 | - | - | - |
| Commercial | - | - | - | - | - |
| Total charge-offs | 118 | 179 | 84 | 1,477 | 1,607 |
| Recoveries: | | | | | |
| Mortgage loans | | | | | |
| One- to four-family | 148 | 135 | 159 | 293 | 811 |
| Multi-family | 21 | 30 | 89 | 208 | 152 |
| Home equity | 27 | 27 | 26 | 26 | 36 |
| Construction and land | 2 | - | 40 | 162 | 72 |
| Commercial real estate | 16 | 25 | 2 | 1 | - |
| Consumer | - | - | - | 1 | - |
| Commercial | - | - | - | - | - |
| Total recoveries | 214 | 217 | 316 | 691 | 1,071 |
| | | | | | |
| Net (recoveries) charge-offs | (96) | (38) | (232) | 786 | 536 |
| Allowance at end of year | $ 18,823 | $ 12,387 | $ 13,249 | $ 14,077 | $ 16,029 |
| | | | | | |
| Ratios: | | | | | |
| Allowance for loan losses to non-performing loans at end of year | 338.54% | 176.33% | 202.12% | 231.99% | 162.62% |
| Allowance for loan losses to loans outstanding at end of year | 1.37% | 0.89% | 0.96% | 1.09% | 1.36% |
| Net (recoveries) charge-offs to average loans: | | | | | |
| Mortgage | | | | | |
| One- to four-family | 0.00% | 0.00% | 0.00% | 0.06% | 0.01% |
| Multi family | 0.00% | 0.00% | 0.00% | (0.01)% | 0.02% |
| Home equity | (0.02)% | 0.02% | (0.03)% | (0.03)% | 0.08% |
| Construction and land | 0.00% | 0.00% | (0.06)% | (0.19)% | (0.09)% |
| Commercial real estate | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Consumer | 0.32% | 0.20% | 0.00% | (0.09)% | 0.00% |
| Commercial | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Net (recoveries) charge-offs to average loans outstanding | (0.01%) | 0.00% | (0.02%) | 0.06% | 0.05% |

***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, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2020 | | | 2019 | | | 2018 | | |
| | 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 | $ 5,459 | 31.04% | 29.00% | $ 4,907 | 34.60% | 39.62% | $ 5,742 | 35.53% | 43.33% |
| Multi-family | 5,600 | 41.59% | 29.75% | 4,138 | 42.14% | 33.41% | 4,153 | 43.29% | 31.35% |
| Home equity | 194 | 1.08% | 1.03% | 201 | 1.30% | 1.62% | 325 | 1.45% | 2.45% |
| Construction and land | 1,755 | 5.61% | 9.32% | 610 | 2.67% | 4.92% | 400 | 0.97% | 3.02% |
| Commercial real estate | 5,138 | 17.33% | 27.30% | 2,145 | 17.05% | 17.32% | 2,126 | 16.35% | 16.05% |
| Commercial | 642 | 3.30% | 3.41% | 372 | 2.18% | 3.00% | 483 | 2.38% | 3.65% |
| Consumer | 35 | 0.05% | 0.19% | 14 | 0.06% | 0.11% | 20 | 0.03% | 0.15% |
| Total allowance for loan losses | $ 18,823 | 100.00% | 100.00% | $ 12,387 | 100.00% | 100.00% | $ 13,249 | 100.00% | 100.00% |

| | At December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | | | 2016 | | |
| | 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 | $ 5,794 | 34.03% | 41.16% | $ 7,164 | 33.35% | 44.70% |
| Multi-family | 4,431 | 44.77% | 31.48% | 4,809 | 47.42% | 30.00% |
| Home equity | 356 | 1.64% | 2.53% | 364 | 1.85% | 2.27% |
| Construction and land | 949 | 1.54% | 6.74% | 1,016 | 1.54% | 6.34% |
| Commercial real estate | 1,881 | 15.16% | 13.36% | 1,951 | 13.53% | 12.17% |
| Commercial | 656 | 2.84% | 4.66% | 713 | 2.28% | 4.45% |
| Consumer | 10 | 0.02% | 0.07% | 12 | 0.03% | 0.07% |
| Total allowance for loan losses | $ 14,077 | 100.00% | 100.00% | $ 16,029 | 100.00% | 100.00% |

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 principles (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, 2020, the allowance for loan losses was $18.8 million, compared to $12.4 million at December 31, 2019. As of December 31, 2020, the allowance for loan losses to total loans receivable was 1.37% and 338.54% of non-performing loans, compared to 0.89%, and 176.33%, respectively at December 31, 2019. The increase in the allowance for loan losses during the year ended December 31, 2020 reflects worse economic conditions due to the COVID-19 pandemic along with an increase of loan downgrades to our Watch category. Additional qualitative risk factors were applied to each of the loan categories primarily to account for the significant increase in the unemployment rate, other economic risks, and those downgrades.

Net recoveries totaled $96,000, or 0.01% of average loans for the year ended December 31, 2020, compared to net recoveries $38,000, or less than 0.01% of average loans for the year ended December 31, 2019. The $58,000 increase in net recoveries was primarily the result of an increase in net recoveries in the one- to four-family and home equity loan categories. Net recoveries related to loans secured by one- to four-family residential loans increased $56,000, to $66,000 in net recoveries for year ended December 31, 2020, as compared to net recoveries of $10,000 for the year ended December 31, 2019. Net recoveries related to loans secured by home equity loans increased $31,000, to net recoveries of $14,000 for year ended December 31, 2020, as compared to net charge-offs of $17,000 for the year ended December 31, 2019. Partially offsetting the increases in net recoveries, net recoveries related to loans secured by multi-family loans decreased $11,000 to net recoveries of $16,000 for year ended December 31, 2020, as compared to net recoveries of $27,000 for the year ended December 31, 2019. Net charge-offs related to loans secured by construction and land loans increased $6,000 to $6,000 in charge-offs for year ended December 31, 2020, as compared to no charge-offs for the year ended December 31, 2019. Net recoveries related to loans secured by commercial real estate loans decreased $7,000, to net recoveries of $16,000 for year ended December 31, 2020, as compared to net recoveries of $23,000 for the year ended December 31, 2019. Net charge-offs related to consumer loans increased $5,000 to $10,000 in charge-offs for year ended December 31, 2020, as compared to $5,000 in charge-offs for the year ended December 31, 2019.

**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 $4.43 billion in mortgage loans held for sale during the year ended December 31, 2020, which was a volume increase of $1.51 billion, or 51.6%, from the $2.92 billion originated during the year ended December 31, 2019. The increase in loan production volume was driven by a $1.18 billion, or 216.2%, increase in refinance products as mortgage rates decreased. Mortgage purchase products increased $330.2 million, or 13.9%, due to an increased housing demand. Total mortgage banking income increased $109.7 million, or 86.5%, to $236.7 million during the year ended December 31, 2020 compared to $126.9 million during the year ended December 31, 2019. The increase in mortgage banking noninterest income was related to a 51.6% increase in volume and an 20.2% increase in gross margin on loans originated and sold for the year ended December 31, 2020 compared to 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. 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 61.1% of total originations during the year ended December 31, 2020, compared to 81.4% of total originations during the year ended December 31, 2019. The mix of loan type trended towards more conventional loans and less governmental loans comprising 75.8% and 24.2% of all loan originations, respectively, during the year ended December 31, 2020, compared to 69.5% and 30.5% of all loan originations, respectively, during the year ended December 31, 2019.

**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, 2020, 2019, and 2018, no investment securities were sold.

**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, collateralized mortgage obligations, and private-label mortgage-backed securities 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, collateralized mortgage obligations, and private-label mortgage-backed securities 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, collateralized mortgage obligations, and private-label mortgage-backed securities 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, 2020, mortgage-backed securities totaled $25.1 million. The mortgage-backed securities portfolio had a weighted average yield of 2.50% and a weighted average remaining life of 4.8 years at December 31, 2020. The estimated fair value of our mortgage-backed securities portfolio at December 31, 2020 was $1.1 million greater than the amortized cost of $24.0 million. Mortgage-backed securities valued at $7.2 million were pledged as collateral for mortgage banking activities as of December 31, 2020. Mortgage-backed securities valued at $785,000 were pledged as collateral for mortgage banking activities as of December 31, 2020. 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, 2020, collateralized mortgage obligations totaled $63.3 million. At December 31, 2020, 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 2.22% and a weighted average remaining life of 2.4 years at December 31, 2020. The estimated fair value of our collateralized mortgage obligations portfolio at December 31, 2020 was $1.7 million greater than the amortized cost of $61.6 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.

***Private-Label Mortgage-backed Securities.*** At December 31, 2020, private-label mortgage-backed securities totaled $3.7 million. These securities had a weighted average yield of 3.04% and a weighted average remaining life of 1.4 years at December 31, 2020. The estimated fair value of our private-label mortgage-backed securities portfolio at December 31, 2020 was $54,000 greater than the amortized cost of $3.6 million. 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.

***Government Sponsored Enterprise Bonds.*** At December 31, 2020, our Government sponsored enterprise bond portfolio totaled $2.5 million, all of which were issued by Federal National Mortgage Association ("Fannie Mae") and were classified as available for sale. The weighted average yield on these securities was 0.60% and the weighted average remaining average life was 4.7 years at December 31, 2020. While these securities generally provide lower yields than other investments in our securities investment portfolio, we maintain these investments, to the extent appropriate, for liquidity purposes and prepayment protection. The estimated fair value of our government sponsored enterprise bond portfolio at December 31, 2020 was $3,000 more than the amortized cost of $2.5 million.

***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, 2020, our municipal obligations portfolio totaled $53.6 million, all of which was classified as available for sale. The weighted average yield on this portfolio was 3.17% at December 31, 2020, with a weighted average remaining life of 4.3 years. The estimated fair value of our municipal obligations bond portfolio at December 31, 2020 was $2.1 million greater than the amortized cost of $51.5 million.

As of December 31, 2020, 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, 2020, 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, 2020, we held other debt securities with a fair value of $11.5 million and amortized cost of $12.5 million. Other debt securities consists of two corporate bonds. The weighted average yield on this portfolio was 1.29% at December 31, 2020, with a weighted average remaining life of 9.3 years. We regularly monitor the credit quality of this portfolio. The unrealized losses for the other debt securities is due to the current slope of the yield curve. One security earns a floating rate that is indexed to the 10 year Treasury interest rate which has decreased over the past few years.

***Portfolio Maturities and Yields.*** The composition and maturities of the securities portfolio at December 31, 2020 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 | $ 3,464 | 2.23% | $ 14,507 | 2.49% | $ 342 | 3.76% | $ 5,692 | 2.61% | $ 24,005 | 2.50% |
| Collateralized mortgage obligations | | - | | - | | - | | - | | - |
| Government sponsored enterprise issued | 4,000 | 2.66% | 57,604 | 2.18% | - | - | - | - | 61,604 | 2.22% |
| Private-label issued | - | - | 3,611 | 3.04% | - | - | - | - | 3,611 | 3.04% |
| Government sponsored enterprise bonds | - | - | 2,500 | 0.60% | - | - | - | - | 2,500 | 0.60% |
| Municipal obligations | 6,934 | 2.18% | 33,809 | 2.50% | 5,646 | 3.26% | 5,123 | 1.89% | 51,512 | 3.17% |
| Other debt securities | - | - | - | - | 12,500 | 1.29% | - | - | 12,500 | 1.29% |
| Total securities available for sale | $ 14,398 | 2.33% | $ 112,031 | 2.31% | $ 18,488 | 1.94% | $ 10,815 | 2.27% | $ 155,732 | 2.50% |

**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, 2020, certificates of deposit comprised 59.2% of total customer deposits, and had a weighted average cost of 0.86% 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, 2020 and December 31, 2019, $701.3 million and $739.8 million of our deposit accounts were certificates of deposit, of which $576.9 million and $665.7 million, respectively, had remaining maturities of one year or less.

Deposits increased by $117.1 million, or 11.0%, from December 31, 2019 to December 31, 2020. The increase in deposits was the result of a $155.5 million, or 47.4%, increase in total transaction accounts offset by a $38.4 million, or 5.2% decrease in time deposits. The Company had no deposits obtained directly from brokers as of December 31, 2020 and December 31, 2019.

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

| | At or For the Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2020 | | | 2019 | | | 2018 | | |
| | 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 | $ 116,771 | - | - | $ 90,497 | - | 0.00% | $ 96,648 | 0.00% | 0.00% |
| NOW accounts | 47,410 | 0.08% | 0.07% | 36,926 | 0.09% | 0.07% | 37,388 | 0.09% | 0.07% |
| Savings and escrow | 75,643 | 0.04% | 0.03% | 72,872 | 0.05% | 0.04% | 77,454 | 0.04% | 0.04% |
| Money market | 189,079 | 0.64% | 0.59% | 125,155 | 0.97% | 1.05% | 95,306 | 0.60% | 0.38% |
| Total transaction accounts | 428,903 | 0.30% | 0.29% | 325,450 | 0.39% | 0.47% | 306,796 | 0.21% | 0.15% |
| Certificates of deposit | 733,033 | 1.71% | 0.86% | 737,397 | 2.17% | 2.18% | 709,102 | 1.55% | 2.01% |
| Total deposits | $ 1,161,936 | 1.19% | 0.63% | $ 1,062,847 | 1.62% | 1.65% | $ 1,015,898 | 1.15% | 1.46% |

At December 31, 2020, the aggregate balance of uninsured deposits of $250,000 or more was $256.0 million. The Company does not have uninsured deposits less than $250,000 in aggregate balance. The following table sets forth the maturity of uninsured certificates of deposits at December 31, 2020.

| | At December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (In Thousands) | |
| Due in: | | |
| Three months or less | $ 22,036 | $ 18,868 |
| Over three months through six months | 28,802 | 16,850 |
| Over six months through 12 months | 32,571 | 46,158 |
| Over 12 months | 19,207 | 9,844 |
| Total | $ 102,616 | $ 91,720 |

***Borrowings.*** Our borrowings at December 31, 2020 consisted of $499.0 million in advances from the Federal Home Loan Bank of Chicago and $9.1 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, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| **Borrowings:** | (Dollars in Thousands) | | |
| Balance outstanding at end of year | $ 508,074 | $ 483,562 | $ 435,046 |
| Weighted average interest rate at the end of year | 1.95% | 2.11% | 2.01% |
| Average balance outstanding during the year | $ 545,741 | $ 484,801 | $ 427,301 |
| Weighted average interest rate during the year | 1.95% | 2.12% | 1.85% |

### Human Capital

As of December 31, 2020, we had approximately 812 full-time equivalent employees. A total of 184 are WaterStone Bank employees and 628 are employees of Waterstone Mortgage Corporation. We believe we are able to attract and retain top talent by creating a culture that challenges and engages our employees, offering them opportunities to learn, grow and achieve their career goals. Further, our commitment to a culture of inclusion is integral to our goal of attracting and retaining the best talent and ultimately driving our business performance. Our Diversity and Inclusion strategy includes regular training and development for all employees and partnerships with non-profit organizations that share in our inclusion mission. Our employees participate in a wide array of volunteer activities and we support their charitable giving by matching employee contributions to qualified nonprofit organizations.

We offer comprehensive compensation and benefits packages to our employees including a 401k Plan, Employee Stock Ownership Plan, healthcare and insurance benefits, health savings and flexible spending accounts, paid time off and certain family assistance programs, including paid family leave, flexible work arrangements, amongst others. We also offer stock-based compensation to certain management personnel as a way to attract and retain key talent. See Note 10 - Stock Based Compensation, Note 11 - Employee Benefit Plans, and Note 12 - Employee Stock Ownership Plan to the Consolidated Financial Statements included under Item 8 for further discussion of our stock-based compensation and benefit plans.

We are committed and focused on the health and safety of our team members, customers, and communities. In response to the COVID-19 pandemic in March 2020, we pivoted to a remote working environment for those employees that could perform their job remotely as part of our commitment to the safety of our employees and the communities we serve. The COVID-19 pandemic presented challenges to maintain team member and client safety while continuing to be open for business. Accordingly, we launched a proactive response to the escalating COVID-19 outbreak that included the creation of an internal coronavirus resource page to manage our pandemic response, including providing access to recent safety standards from the Centers for Disease Control and Prevention, the World Health Organization, and other agencies; as well as our workplace guidelines for non-customer and customer environments. In addition, current information is shared through regular emails and other digital communications with our team members. Additional actions included adjusting our lobby usage and encouraging team members to work remotely where possible during the pandemic. Our banking centers are still open for business and we continue to lend to qualified businesses for working capital and general business purposes.

### 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 pay dividends, repurchase shares of common stock, 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.* Federal law 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. Federal law also 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, 2020, 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, 2020, WaterStone Bank maintained 89.3% 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.* Under Wisconsin law, WaterStone Bank is permitted to establish deposit accounts and accept deposits. WaterStone Bank's board of directors, or its designee, determine the rate and amount of interest to be paid on or credited to deposit accounts.

*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 received credits for the portion of their assessments that contributed to the reserve ratio between 1.15% and 1.35%. Those credits were exhausted as of September 30, 2020. 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 total 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, 2020, WaterStone Bank's capital to assets ratio, as calculated under Wisconsin law, was 17.13%.

*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 Reserve Board, to establish a "community bank leverage ratio" of between 8 to 10% of average total consolidated assets for qualifying institutions with assets of less than $10 billion. Institutions with capital meeting the specified requirements and electing to follow the alternative framework are deemed to comply with the applicable regulatory capital requirements, including the risk-based requirements. A qualifying institution may opt in and out of the community bank leverage ratio on its quarterly call report.

The federal regulators issued a final rule that set the optional community bank leverage ratio at 9%, commencing the first quarter of 2020. The rule also established a two-quarter grace period for a qualifying institution that ceases to meet any qualifying criteria provided that the bank maintains a leverage ratio 8% or greater.

Section 4012 of the Coronavirus Aid, Relief and Economic Security Act of 2020 required that the community bank leverage ratio be temporarily lowered to 8%. The federal regulators issued a rule implementing the lower ratio effective April 23, 2020. The rule also established a two-quarter grace period for a qualifying institution whose leverage ratio falls below the 8% community bank leverage ratio requirement so long as the bank maintains a leverage ratio of 7% or greater. Another rule was issued to transition back to the 9% community bank leverage ratio by increasing the ratio to 8.5% for calendar year 2021 and 9% thereafter.

***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, 2020, WaterStone Bank was considered well-capitalized with a common equity Tier 1 ratio of 21.44%, Tier 1 leverage ratio of 16.62%, a Tier 1 risk-based ratio of 21.44% and a total risk based capital ratio of 22.52%.

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 Standards 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 "Impact of 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, 2020, 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, 2020, 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. However, effective March 26, 2020, the Federal Reserve Board reduced reserve requirement ratios to zero, thereby effectively eliminating the requirements. The Federal Reserve Board took that action due to a change in its approach to monetary policy; it has indicated that it has no plans to re-impose reserve requirements but could in the future if conditions warrant.

***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, 2020, the rate of interest on an employee rate mortgage loan was 1.73%, compared to the weighted average rate of 4.27% on all single family mortgage loans. This rate will increase to 1.02% effective March 1, 2021. Employee rate mortgage loans totaled $751,000, or 0.2%, of our single family residential mortgage loan portfolio on December 31, 2020.

***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 $26.7 million at December 31, 2020.

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, 2020, WaterStone Bank had $499.0 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, that 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 stock 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 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, the Savings and Loan Holding Company Act provides that no company may acquire control of a savings and loan holding company (as "control" is defined for purposes of that statute) 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. Effective September 30, 2020, the Federal Reserve Board adopted changes to its regulatory definition of "control" under the Savings and Loan Holding Company Act. Relevant factors include a company's voting and nonvoting equity interests in the savings and loan holding company, director, officer and employee overlaps and the scope of business relationships between the company and the savings and loan holding company or its subsidiary institution.

## 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 2017.

*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, 2020, 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, 2020, 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 2016.

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.

### Risks Related to the COVID-19 Pandemic

**The COVID-19 pandemic has adversely impacted our business and financial results, and the ultimate impact will depend on future developments, which are highly uncertain and cannot be predicted, including the scope and duration of the pandemic and actions taken by governmental authorities in response to the pandemic.**

The COVID-19 pandemic is creating extensive disruptions to the global economy and to the lives of individuals throughout the world. Governments, businesses, and the public are taking unprecedented actions to contain the spread of COVID-19 and to mitigate its effects, including quarantines, travel bans, shelter-in-place orders, closures of businesses and schools, fiscal stimulus, and legislation designed to deliver monetary aid and other relief. While the scope, duration, and full effects of COVID-19 are rapidly evolving and not fully known, the pandemic and related efforts to contain it have disrupted global economic activity, adversely affected the functioning of financial markets, impacted interest rates, increased economic and market uncertainty, and disrupted trade and supply chains. If these effects continue for a prolonged period or result in sustained economic stress or recession, many of the risk factors identified in our Form 10-K could be exacerbated and such effects could have a material adverse impact on us in a number of ways related to credit, collateral, customer demand, funding, operations, interest rate risk, human capital and self-insurance, as described in more detail below.

- Credit Risk. Our risks of timely loan repayment and the value of collateral supporting the loans are affected by the strength of our borrower's business. Concern about the spread of COVID-19 has caused and is likely to continue to cause business shutdowns, limitations on commercial activity and financial transactions, labor shortages, supply chain interruptions, increased unemployment and commercial property vacancy rates, reduced profitability and ability for property owners to make mortgage payments, and overall economic and financial market instability, all of which may cause our customers to be unable to make scheduled loan payments. If the effects of COVID-19 result in widespread and sustained repayment shortfalls on loans in our portfolio, we could incur significant delinquencies, foreclosures and credit losses, particularly if the available collateral is insufficient to cover our exposure. The future effects of COVID-19 on economic activity could negatively affect the collateral values associated with our existing loans, the ability to liquidate the real estate collateral securing our residential and commercial real estate loans, our ability to maintain loan origination volume and to obtain additional financing, the future demand for or profitability of our lending and services, and the financial condition and credit risk of our customers. Further, in the event of delinquencies, regulatory changes and policies designed to protect borrowers may slow or prevent us from making our business decisions or may result in a delay in our taking certain remediation actions, such as foreclosure. In addition, we have unfunded commitments to extend credit to customers. During a challenging economic environment like now, our customers are more dependent on our credit commitments and increased borrowings under these commitments could adversely impact our liquidity. Furthermore, in an effort to support our communities during the pandemic, we are participating in the Paycheck Protection Program ("PPP") under the CARES Act whereby loans to small businesses are made and those loans are subject to the regulatory requirements that would require forbearance of loan payments for a specified time or that would limit our ability to pursue all available remedies in the event of a loan default. If the borrower under the PPP loan fails to qualify for loan forgiveness, we are at the heightened risk of holding these loans at unfavorable interest rates as compared to the loans to customers to which we would have otherwise extended credit.

- Strategic Risk. Our success may be affected by a variety of external factors that may affect the price or marketability of our products and services, changes in interest rates that may increase our funding costs, reduced demand for our financial products due to economic conditions and the various response of governmental and nongovernmental authorities. In recent weeks, the COVID-19 pandemic has significantly increased economic and demand uncertainty and has led to disruption and volatility in the global capital markets. Furthermore, many of the governmental actions have been directed toward curtailing household and business activity to contain COVID-19. These actions have been rapidly expanding in scope and intensity. For example, in many of our markets, local governments have acted to temporarily close or restrict the operations of most businesses. The future effects of COVID-19 on economic activity could negatively affect the future banking products we provide, including a decline in originating of loans.

- Operational Risk. Current and future restrictions on our workforce's access to our facilities could limit our ability to meet customer servicing expectations and have a material adverse effect on our operations. We rely on business processes and branch activity that largely depend on people and technology, including access to information technology systems as well as information, applications, payment systems and other services provided by third parties. In response to COVID-19, we have modified our business practices with a portion of our employees working remotely from their homes to have our operations uninterrupted as much as possible. Further, technology in employees' homes may not be as robust as in our offices and could cause the networks, information systems, applications, and other tools available to employees to be more limited or less reliable than in our offices. The continuation of these work-from-home measures also introduces additional operational risk, including increased cybersecurity risk. These cyber risks include greater phishing, malware, and other cybersecurity attacks, vulnerability to disruptions of our information technology infrastructure and telecommunications systems for remote operations, increased risk of unauthorized dissemination of confidential information, limited ability to restore the systems in the event of a systems failure or interruption, greater risk of a security breach resulting in destruction or misuse of valuable information, and potential impairment of our ability to perform critical functions, including wiring funds, all of which could expose us to risks of data or financial loss, litigation and liability and could seriously disrupt our operations and the operations of any impacted customers.

  Moreover, we rely on many third parties in our business operations, including the appraiser of the real property collateral, vendors that supply essential services such as loan servicers, providers of financial information, systems and analytical tools and providers of electronic payment and settlement systems, and local and federal government agencies, offices, and courthouses. In light of the developing measures responding to the pandemic, many of these entities may limit the availability and access of their services. For example, loan origination could be delayed due to the limited availability of real estate appraisers for the collateral. Loan closings could be delayed related to reductions in available staff in recording offices or the closing of courthouses in certain counties, which slows the process for title work, mortgage and UCC filings in those counties. If the third-party service providers continue to have limited capacities for a prolonged period or if additional limitations or potential disruptions in these services materialize, it may negatively affect our operations.

- Interest Rate Risk. Our net interest income, lending activities, deposits and profitability could be negatively affected by volatility in interest rates caused by uncertainties stemming from COVID-19. In March 2020, the Federal Reserve lowered the target range for the federal funds rate to a range from 0 to 0.25 percent, citing concerns about the impact of COVID-19 on markets and stress in the energy sector. A prolonged period of extremely volatile and unstable market conditions would likely increase our funding costs and negatively affect market risk mitigation strategies. Higher income volatility from changes in interest rates and spreads to benchmark indices could cause a loss of future net interest income and a decrease in current fair market values of our assets. Fluctuations in interest rates will impact both the level of income and expense recorded on most of our assets and liabilities and the market value of all interest-earning assets and interest-bearing liabilities, which in turn could have a material adverse effect on our net income, operating results, or financial condition.

Because there have been no comparable recent global pandemics that resulted in similar global impact, we do not yet know the full extent of COVID-19's effects on our business, operations, or the global economy as a whole. Any future development will be highly uncertain and cannot be predicted, including the scope and duration of the pandemic, the effectiveness of our work from home arrangements, third party providers' ability to support our operation, and any actions taken by governmental authorities and other third parties in response to the pandemic. The uncertain future development of this crisis could materially and adversely affect our business, operations, operating results, financial condition, liquidity or capital levels.

**Risks Related to Regulatory Matters**

**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.

**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.

**Risks Related to Interest Rates**

**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 "Quantitative and Qualitative Disclosures About Market Risk—Management of Market Risk."

**Risks Related to Lending Matters**

**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.

**We are subject to regulatory enforcement risk, reputation risk and litigation risk regarding our participation in the PPP, and we are subject to the risk that the SBA may not fund some or all PPP loan guarantees.**

The CARES Act included the PPP as a loan program administered through the SBA. Under the PPP, small businesses and other entities and individuals can apply for loans from existing SBA lenders and other approved regulated lenders that enroll in the program, subject to detailed qualifications and eligibility criteria.

Because of the short timeframe between the passing of the CARES Act and implementation of the PPP, some of the rules and guidance relating to PPP were issued after lenders began processing PPP applications. Also, there was and continues to be uncertainty in the laws, rules and guidance relating to the PPP. Since the opening of the PPP, several banks have been subject to litigation regarding the procedures used in processing PPP applications, and several banks have been subject to litigation regarding the payment of fees to agents that assisted borrowers in obtaining PPP loans. In addition, some banks and borrowers have received negative media attention associated with PPP loans. Although we believe that we have administered the PPP in accordance with all applicable laws, regulations and guidance, we may be exposed to litigation risk and negative media attention related to our participation in the PPP. If any such litigation is not resolved in in our favor, it may result in significant financial liability to us or adversely affect our reputation. In addition, litigation can be costly, regardless of outcome. Any financial liability, litigation costs or reputational damage caused by PPP-related litigation or media attention could have a material adverse impact on our business, financial condition, and results of operations.

The PPP has also attracted interest from federal and state enforcement authorities, oversight agencies, regulators, and U.S. Congressional committees. State Attorneys General and other federal and state agencies may assert that they are not subject to the provisions of the CARES Act and the PPP regulations entitling us to rely on borrower certifications, and take more aggressive action against us for alleged violations of the provisions governing the PPP. Federal and state regulators can impose or request that we consent to substantial sanctions, restrictions and requirements if they determine there are violations of laws, rules or regulations or weaknesses or failures with respect to general standards of safety and soundness, which could adversely affect our business, reputation, results of operation and financial condition, and thereby adversely affect your investment.

We also have credit risk on PPP loans if the SBA determines that there is a deficiency in the manner in which we originated, funded or serviced loans, including any issue with the eligibility of a borrower to receive a PPP loan. In the event of a loss resulting from a default on a PPP loan and a determination by the SBA that there was a deficiency in the manner in which we originated, funded or serviced a PPP loan, the SBA may deny its liability under the guaranty, reduce the amount of the guaranty or, if the SBA has already paid under the guaranty, seek recovery of any loss related to the deficiency from us.

**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. In addition, any future credit deterioration, including as a result of COVID-19, could require us to increase our allowance for loan losses in the future.

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.

**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.

**Risks Related to Operational Matters**

**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 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.

**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.

**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.

**Risks Related to Competitive Matters**

**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.

**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.

**Risks Related to Mortgage Banking 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.

**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.

**Risks Related to Economic Matters**

**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.

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.

**Risks Related to Accounting Matters**

**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.

**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.

**Other Risks Related to Our Business**

**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.

**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.

**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.

**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.

**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.

**Item 1B. Unresolved Staff Comments**

None

## Item 2. Properties

We operate from our corporate center, our 14 full-service banking offices, our drive-through office and 14 automated teller machines, located in Milwaukee, Washington and Waukesha Counties, Wisconsin. The net book value of our premises, land, equipment and leasehold improvements was $23.7 million at December 31, 2020. The following table sets forth information with respect to our corporate center and our full-service banking offices as of December 31, 2020.

| | | |
|---|---|---|
| Corporate Center<br>11200 West Plank Court<br>Wauwatosa, Wisconsin 53226 | Wauwatosa<br>7500 West State Street<br>Wauwatosa, Wisconsin 53213 | Brookfield (1)<br>17495 W Capitol Dr.<br>Brookfield, Wisconsin 53045 |
| Franklin/Hales Corners<br>6555 South 108th Street<br>Franklin, Wisconsin 53132 | Germantown/Menomonee Falls<br>W188N9820 Appleton Avenue<br>Germantown, Wisconsin 53022 | Oak Creek<br>6560 South 27th Street<br>Oak Creek, Wisconsin 53154 |
| Oconomowoc/Lake Country (1)<br>1233 Corporate Center Drive<br>Oconomowoc, Wisconsin 53066 | Pewaukee<br>1230 George Towne Drive<br>Pewaukee, Wisconsin 53072 | Waukesha/Brookfield<br>21505 East Moreland Blvd.<br>Waukesha, Wisconsin 53186 |
| West Allis/Greenfield Avenue<br>10101 West Greenfield Avenue<br>West Allis, Wisconsin 53214 | Fox Point/North Shore<br>8607 North Port Washington Road<br>Fox Point, Wisconsin 53217 | Greenfield/Loomis Road<br>5000 West Loomis Road<br>Greenfield, Wisconsin 53220 |
| West Allis/National Avenue<br>10296 West National Avenue<br>West Allis, Wisconsin 53227 | Oak Creek/Howell Avenue<br>8780 South Howell Avenue<br>Oak Creek, Wisconsin 53154 | Milwaukee/Oklahoma Avenue<br>6801 West Oklahoma Avenue<br>Milwaukee, WI 53219 |

(1) Leased property

In addition to our banking offices, as of December 31, 2020, Waterstone Mortgage Corporation had nine offices in Wisconsin, eight offices in each of Florida and New Mexico, four offices in Minnesota, three offices in each of Illinois and Texas, two offices in each of Arizona, Colorado, Idaho, Maryland, Ohio, Oklahoma, Oregon, and Virginia, and one office in each of Arkansas, California, Georgia, Iowa, Michigan, New Hampshire, Pennsylvania, and Tennessee.

## 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.

## 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 26, 2021 was 1,400. On that same date there were 25,117,634 shares of common stock issued and outstanding.

Following are the Company's monthly common stock repurchases during the fourth quarter of 2020.

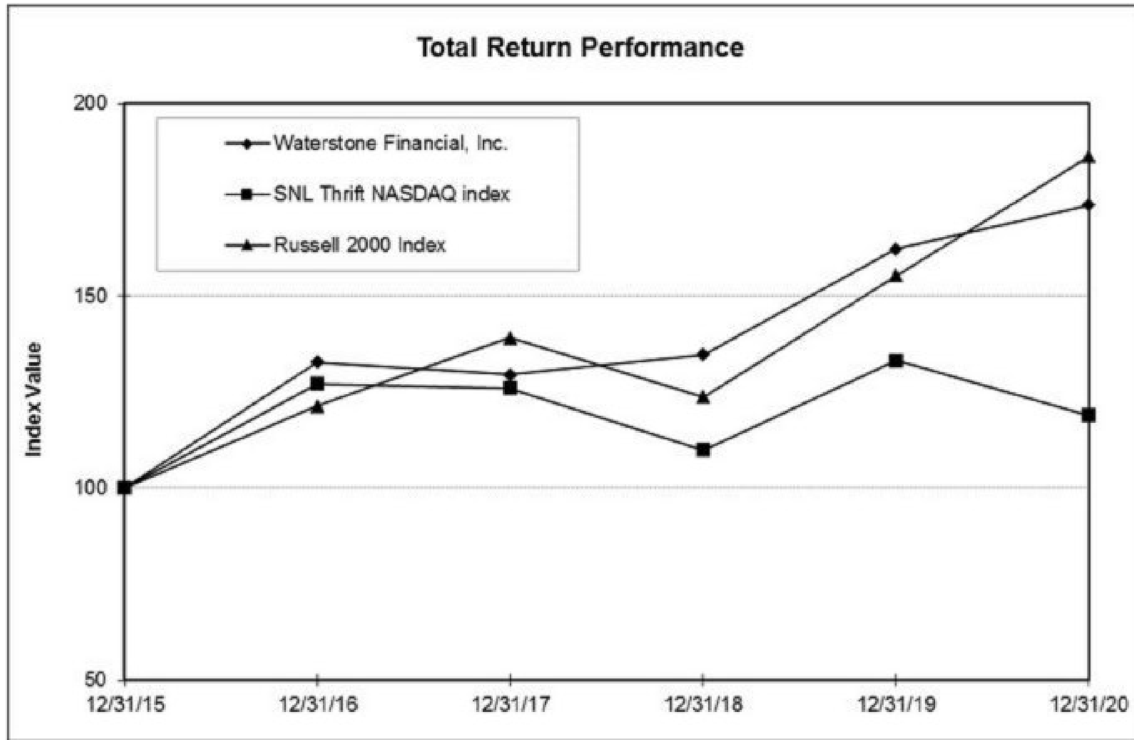
| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Maximum Number of Shares that May Yet Be Purchased Under the Plan[a] |
|---|---|---|---|---|
| October 1, 2020 - October 31, 2020 | 46,800 | $ 16.28 | 46,800 | 1,153,238 |
| November 1, 2020 - November 30, 2020 | 119,700 | 17.54 | 119,700 | 1,033,538 |
| December 1, 2020 - December 31, 2020 | 36,775 | 17.97 | 36,775 | 996,763 |
| Total | 203,275 | $ 17.32 | 203,275 | 996,763 |

(a) On July 21, 2020, 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, 2015, in Waterstone Financial, Inc. common stock and each of those indices.

## *Waterstone Financial, Inc.*




| Index | 12/31/15 | 12/31/16 | 12/31/17 | 12/31/18 | 12/31/19 | 12/31/20 |
|---|---|---|---|---|---|---|
| Waterstone Financial, Inc. | 100.00 | 132.75 | 129.54 | 134.73 | 162.24 | 173.58 |
| SNL Thrift NASDAQ index | 100.00 | 127.14 | 125.92 | 109.90 | 133.21 | 118.96 |
| Russell 2000 | 100.00 | 121.31 | 139.08 | 123.76 | 155.35 | 186.36 |

**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.

| | At or for the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| | (In Thousands, except per share amounts) | | | | |
| **Selected Financial Condition Data:** | | | | | |
| Total assets | $ 2,184,587 | $ 1,996,347 | $ 1,915,381 | $ 1,806,401 | $ 1,790,619 |
| Cash and cash equivalents | 94,767 | 74,300 | 86,101 | 48,607 | 47,217 |
| Securities available for sale | 159,619 | 178,476 | 185,720 | 199,707 | 226,795 |
| Loans held for sale | 402,003 | 220,123 | 141,616 | 149,896 | 225,248 |
| Loans receivable | 1,375,137 | 1,388,031 | 1,379,148 | 1,291,814 | 1,177,884 |
| Allowance for loan losses | 18,823 | 12,387 | 13,249 | 14,077 | 16,029 |
| Loans receivable, net | 1,356,314 | 1,375,644 | 1,365,899 | 1,277,737 | 1,161,855 |
| Real estate owned, net | 322 | 748 | 2,152 | 4,558 | 6,118 |
| Deposits | 1,184,870 | 1,067,776 | 1,038,495 | 967,380 | 949,411 |
| Borrowings | 508,074 | 483,562 | 435,046 | 386,285 | 387,155 |
| Total shareholders' equity | 413,118 | 393,686 | 399,679 | 412,104 | 410,690 |
| **Selected Operating Data:** | | | | | |
| Interest income | $ 78,484 | $ 79,741 | $ 73,700 | $ 67,095 | $ 63,736 |
| Interest expense | 24,984 | 27,544 | 19,523 | 16,362 | 20,292 |
| Net interest income | 53,500 | 52,197 | 54,177 | 50,733 | 43,444 |
| Provision for loan losses | 6,340 | (900) | (1,060) | (1,166) | 380 |
| Net interest income after provision for loan losses | 47,160 | 53,097 | 55,237 | 51,899 | 43,064 |
| Noninterest income | 244,017 | 130,750 | 118,199 | 124,413 | 126,365 |
| Noninterest expense | 183,061 | 136,273 | 133,156 | 131,879 | 127,435 |
| Income before income taxes | 108,116 | 47,574 | 40,280 | 44,433 | 41,994 |
| Provision for income taxes | 26,971 | 11,671 | 9,526 | 18,469 | 16,462 |
| Net income | $ 81,145 | $ 35,903 | $ 30,754 | $ 25,964 | $ 25,532 |
| Per common share: | | | | | |
| Income per share - basic | $ 3.32 | $ 1.38 | $ 1.12 | $ 0.95 | $ 0.94 |
| Income per share - diluted | $ 3.30 | $ 1.37 | $ 1.11 | $ 0.93 | $ 0.93 |
| Book value | $ 16.47 | $ 14.50 | $ 14.04 | $ 13.97 | $ 13.95 |
| Dividends declared | $ 1.36 | $ 0.98 | $ 0.98 | $ 0.98 | $ 0.33 |

| | At or for the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| **Selected Financial Ratios and Other Data:** | | | | | |
| Performance Ratios: | | | | | |
| Return on average assets | 3.77% | 1.82% | 1.64% | 1.43% | 1.45% |
| Return on average equity | 20.18 | 9.14 | 7.60 | 6.32 | 6.33 |
| Interest rate spread (1) | 2.34 | 2.44 | 2.75 | 2.69 | 2.27 |
| Net interest margin (2) | 2.67 | 2.83 | 3.09 | 3.00 | 2.64 |
| Noninterest expense to average assets | 8.50 | 6.91 | 7.12 | 7.29 | 7.24 |
| Efficiency ratio (3) | 61.53 | 74.49 | 77.25 | 75.30 | 75.05 |
| Average interest-earning assets to average interest-bearing liabilities | 126.07 | 126.40 | 130.14 | 131.86 | 130.56 |
| Dividend payout ratio (4) | 38.55 | 71.01 | 87.50 | 103.16 | 27.66 |
| | | | | | |
| Capital Ratios: | | | | | |
| Waterstone Financial, Inc.: | | | | | |
| Equity to total assets at end of period | 18.91% | 19.72% | 20.87% | 22.81% | 22.94% |
| Average equity to average assets | 18.68 | 19.91 | 21.63 | 22.70 | 22.90 |
| Total capital to risk-weighted assets | 24.80 | 26.17 | 28.22 | 30.75 | 32.23 |
| Tier 1 capital to risk-weighted assets | 23.71 | 25.37 | 27.32 | 29.74 | 31.02 |
| Common equity tier 1 capital to risk-weighted assets | 23.71 | 25.37 | 27.32 | 29.74 | 31.02 |
| Tier 1 capital to average assets | 18.38 | 19.69 | 21.06 | 22.43 | 23.20 |
| WaterStone Bank: | | | | | |
| Total capital to risk-weighted assets | 22.52 | 22.85 | 26.95 | 28.93 | 29.50 |
| Tier I capital to risk-weighted assets | 21.44 | 22.05 | 26.05 | 27.92 | 28.29 |
| Common equity tier 1 capital to risk-weighted assets | 21.44 | 22.05 | 26.05 | 27.92 | 28.29 |
| Tier I capital to average assets | 16.61 | 17.11 | 20.08 | 21.10 | 21.17 |
| | | | | | |
| Asset Quality Ratios: | | | | | |
| Allowance for loan losses as a percent of total loans | 1.37% | 0.89% | 0.96% | 1.09% | 1.36% |
| Allowance for loan losses as a percent of non-performing loans | 338.54 | 176.33 | 202.12 | 231.99 | 162.62 |
| Net (recoveries) charge-offs to average outstanding loans during the period | (0.01) | (0.00) | (0.02) | 0.06 | 0.05 |
| Non-performing loans as a percent of total loans | 0.40 | 0.51 | 0.48 | 0.47 | 0.84 |
| Non-performing assets as a percent of total assets | 0.27 | 0.39 | 0.45 | 0.59 | 0.89 |
| | | | | | |
| Other Data: | | | | | |
| Number of full-service banking offices | 14 | 13 | 11 | 11 | 11 |
| Number of full-time equivalent employees | 812 | 824 | 888 | 927 | 895 |

(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 year ended December 31, 2020, compared to the year ended December 2019, and the financial condition as of December 31, 2020 compared to the financial condition as of December 31, 2019.

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, 2020, compared the year ended December 31, 2019, 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, 2019 compared to the year ended December 31, 2018, 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 2019 Form 10-K, filed with the SEC on March 13, 2020.

**Significant Items**

Earnings comparisons among the three years ended December 31, 2020, 2019, and 2018 were impacted by the Significant Items summarized below.

**COVID-19 and the CARES Act**

The COVID-19 pandemic has caused economic and social disruption on an unprecedented scale. While some industries have been impacted more severely than others, all businesses have been impacted to some degree. This disruption has resulted in the shuttering of businesses across the country, significant job loss, and aggressive measures by the federal government.

Congress, the President, and the Federal Reserve have taken several actions designed to cushion the economic fallout. Most notably, the Coronavirus Aid, Relief and Economic Security ("CARES") Act was signed into law at the end of March 2020 as a $2 trillion legislative package. The goal of the CARES Act is to prevent a severe economic downturn through various measures, including direct financial aid to American families and economic stimulus to significantly impacted industry sectors. The package also includes extensive emergency funding for hospitals and providers. In addition to the general impact of COVID-19, certain provisions of the CARES Act as well as other recent legislative and regulatory relief efforts are expected to have a material impact on our operations. While it is not possible to know the full universe or extent of these impacts as of the date this filing, we are disclosing potentially material items of which we are aware.

- The CARES Act allows for a temporary delay in the adoption of accounting guidance under Accounting Standards Codification Topic 326, "Financial Instruments – Credit Losses ("CECL") until the earlier of December 31, 2020 or after the end of the COVID-19 national emergency. During the quarter ended March 31, 2020, pursuant to the recently-enacted CARES Act and guidance from the Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB"), we elected to delay adoption of CECL. On December 27, 2020, the Consolidated Appropriations Act, 2021 was signed into law. Among other provisions, this Act extended the temporary delay on the adoption of CECL until January 1, 2022. The December 31, 2020 financial statements include an allowance for loan losses that was prepared under the existing incurred loss methodology.

- Under the CARES Act, loans less than 30 days past due as of December 31, 2019 and COVID-19 impacted loans which involved principal deferrals or principal and interest deferrals are considered current. A financial institution suspended the requirements under GAAP for loan modifications related to COVID-19 that would otherwise be categorized as a troubled debt restructuring ("TDR"). In keeping with regulatory guidance to work with borrowers during this unprecedented situation, the Company has executed a payment deferral program for our lending clients that are adversely affected by the pandemic. As of December 31, 2020, the Company had modified three loans totaling $1.2 million consisting of principal deferrals or principal and interest deferrals. In accordance with the CARES Act issued in April 2020 and the Consolidated Appropriations Act, 2021 signed in December 2020, these short-term deferrals are not considered troubled debt restructurings.

- The CARES Act authorized the Small Business Administration ("SBA") to temporarily guarantee loans under a new loan program call the Paycheck Protection Program ("PPP"). As a qualified SBA lender, we were automatically authorized to originate PPP loans. The Company is actively participating in assisting our customers with applications for resources through the program. PPP loans will have: (a) an interest rate of 1.0%, (b) a five-year loan term to maturity for loans made on or after June 5, 2020 (loans made prior to June 5, 2020 have a two-year term, however borrowers and lenders may mutually agree to extend the maturity for such loans to five years); and (c) principal and interest payments deferred for six months from the date of disbursement. The SBA will guarantee 100% of the PPP loans made to eligible borrowers. The entire principal amount of the borrower's PPP loan, including any accrued interest, is eligible to be reduced by the loan forgiveness amount under the PPP. During the year ended December 31, 2020, the Company originated a total of $30.1 million in PPP loans for customers and recognized $480,000 in fees received from the SBA. As of December 31, 2020, we have PPP loans outstanding totaling $18.1 million.

Our fee income could be reduced due to COVID-19. In keeping with guidance from regulators, we are working with COVID-19 affected customers to waive fees from a variety of sources, such as, but not limited to, insufficient funds and overdraft fees, ATM fees, account maintenance fees, etc. These reductions in fees are thought, at this time, to be temporary in conjunction with the length of the expected COVID-19 related economic crisis. At this time, we are unable to project the materiality of such an impact, but recognize the breadth of the economic impact is likely to impact our fee income in future periods.

Our interest income could be reduced due to COVID-19. In keeping with guidance from regulators, we are actively working with COVID-19 affected borrowers to defer their payments, interest, and fees. While interest and fees will still accrue to income, through normal GAAP accounting, should eventual credit losses on these deferred payments emerge, interest income and fees accrued would need to be reversed. In such a scenario, interest income in future periods could be negatively impacted. At this time, we are unable to project the materiality of such an impact, but recognize the breadth of the economic impact may affect our borrowers' ability to repay in future periods.

*Capital and liquidity*

As of December 31, 2020, all of our capital ratios, and our subsidiary bank's capital ratios, were in excess of all regulatory requirements. While we believe that we have sufficient capital to withstand an extended economic recession brought about by COVID-19, our reported and regulatory capital ratios could be adversely impacted by further credit losses.

We maintain access to multiple sources of liquidity. Wholesale funding markets have remained open to us, but rates for short term funding have recently been volatile. If funding costs are elevated for an extended period of time, it could have an adverse effect on our net interest margin. If an extended recession causes large numbers of our deposit customers to withdraw their funds, we might become more reliant on volatile or more expensive sources of funding.

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

**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 consolidated statements of operations.

***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 consolidated statements of operations 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, 2020 and at December 31, 2019**

***Total Assets.*** Total assets increased by $188.2 million, or 9.4%, to $2.18 billion at December 31, 2020 from $2.00 billion at December 31, 2019. The increase in total assets primarily reflects an increase in loans held for sale, cash and cash equivalents, and prepaid expenses and other assets due to an increase in the fair market value of the loan rate lock commitments partially offset by a decrease in securities available for sale and loans receivable. The total assets increase reflects liability increases in deposits, additional short-term debt, and other liabilities due to hedging liabilities.

***Cash and Cash Equivalents.*** Cash and cash equivalents increased $20.5 million to $94.8 million at December 31, 2020 from $74.3 million at December 31, 2019. The increase in cash and cash equivalents primarily reflects the additional source of funds through an increase in deposits and short-term borrowings along with available for sale securities payments and loans held for investment payoffs. Offsetting the increases, cash and cash equivalents decreased primarily due to the use of cash to fund loans held for sale, pay dividends, and repurchase shares since December 31, 2019.

***Securities Available for Sale.*** Securities available for sale decreased by $18.9 million to $159.6 million at December 31, 2020 from $178.5 million at December 31, 2019. 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 $181.9 million, or 82.6%, to $402.0 million at December 31, 2020 from $220.1 million at December 31, 2019. 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 decreased $12.9 million, or 0.9%, to $1.38 billion at December 31, 2020 from $1.39 billion at December, 31, 2019. The decrease in total loans receivable was primarily attributable to decreases in the one- to four-family, multi-family, home equity, and consumer categories. Offsetting those decreases, the construction and land, commercial real estate, and commercial loan categories increased. The growth in the commercial loan category was driven by $18.1 million of PPP loans originated and still outstanding during the year ended December 31, 2020.

***Allowance for Loan Losses.*** The allowance for loan losses increased $6.4 million to $18.8 million at December 31, 2020 from $12.4 million at December 31, 2019. The increase resulted from a provision due to increased economic uncertainty increasing the required allowance related to the loans collectively reviewed. The overall increase was primarily related to each of the one- to four-family, multi-family, construction and land, commercial real estate, consumer, and commercial 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 $5.6 million to $26.7 million at December 31, 2020 from $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 decreased $6.1 million, to $63.6 million at December 31, 2020 from $69.7 million. The decrease is primarily related to the death benefit received on two policies during 2020 offset by continued earnings and annual premiums paid.

***Real Estate Owned.*** Total real estate owned decreased $426,000, to $322,000 at December 31, 2020, compared to $748,000 at December 31, 2019. During the year ended December 31, 2020, $637,000 was transferred from loans to real estate owned upon completion of foreclosure. During the same period, sales of real estate owned totaled $1.1 million. There were no write-downs during the year ended December 31, 2020.

***Prepaid Expenses and Other Assets.*** Total prepaid expenses and other assets increased $26.3 million to $57.5 million at December 31, 2020 from $31.2 million at December 31, 2019. The increase was primarily due to increases in loan rate lock commitments, funding receivables from investors, and receivables from back-to-back interest rate swaps.

***Deposits.*** Deposits increased by $117.1 million to $1.18 billion at December 31, 2020, from $1.07 billion at December 31, 2019. The increase was driven by an increase of $97.4 million in money market and savings deposits and $58.2 million in demand deposits offset by a decrease of $38.4 million in time deposits.

***Borrowings.*** Total borrowings increased $24.5 million to $508.1 million at December 31, 2020, from $483.6 million at December 31, 2019. The community banking segment added $29.0 million in short-term FHLB borrowings. External short-term borrowings at the mortgage banking segment decreased a total of $4.5 million to $9.0 million at December 31, 2020 from $13.6 million at December 31, 2019.

***Other Liabilities.*** Other liabilities increased $27.9 million to $75.0 million at December 31, 2020 compared to $47.1 million at December 31, 2019. Other liabilities increased primarily due to liabilities resulting from payables due on back-to-back swaps, legal settlement, accrued compensation, dividends payable, and forward commitments to sell loans at the mortgage banking segment.

***Shareholders' Equity.*** Shareholders' equity increased by $19.4 million, or 4.9%, to $413.1 million at December 31, 2020 from $393.7 million at December 31, 2019. Shareholders' equity increased primarily due to net income, additional paid-in capital as stock options were exercised and equity awards vested, an increase in fair value of the security portfolio, and unearned ESOP shares vesting. Partially offsetting the increases, there were decreases due to the declaration of regular and special dividends and the repurchase of stock.

**Comparison of Community Banking Segment Operations for the Years Ended December 31, 2020 and 2019**

Net income from our community banking segment for the year ended December 31, 2020 totaled $21.2 million compared to $24.6 million for the year ended December 31, 2019. Net interest income increased $597,000 to $54.6 million for the year ended December 31, 2020 compared to $54.0 million for the year ended December 31, 2019. Net interest income increased primarily due to a decrease in interest expense as interest on time deposits decreased as replacement rates were lower. Partially offsetting the decrease in interest expense, interest income decreased primarily due to decreases in loan interest, mortgage-related securities, and debt securities, federal funds sold and short-term investments interest.

The Company delayed adoption of ASC Topic 326 as permitted under the CARES Act. The Company calculated the allowance using the incurred loss model. Provision for loan losses was $6.1 million for the year ended December 31, 2020 compared to a negative provision of $1.1 million for the year ended December 31, 2019 as economic conditions significantly worsened during the year ended December 31, 2020.

Noninterest income increased $3.7 million for the year ended December 31, 2020 due primarily to increases in loan fees and a gain from death benefits on bank owned life insurance. The loan fees increased primarily due to loan prepayment fees and fees earned on loan swaps. Cash surrender value of life insurance decreased as the balance decreased due to death benefit proceeds received on two bank owned life insurance policies. Other income increased primarily due to gain on death benefits, wealth management fees, and rental income.

Compensation, payroll taxes, and other employee benefits expense increased $2.0 million to $20.2 million due primarily to an increase in salaries expense, health insurance expense, and variable compensation. Occupancy, office furniture and equipment decreased due primarily to computer supplies and snow plowing expense. Data processing and advertising expense increased primarily due to the rollout of a new digital banking platform and promotions for deposit customers during the year ended December 31, 2020. Communications expense, real estate owned, and other expenses increased while professional fees expense decreased.

**Comparison of Mortgage Banking Segment Operations for the Years Ended December 31, 2020 and 2019**

Net income totaled $59.9 million for the year ended December 31, 2020 compared to $11.2 million for the year ended December 31, 2019. We originated $4.43 billion in mortgage loans held for sale (including sales to the community banking segment) during the year ended December 31, 2020, which represents an increase of $1.51 billion, or 51.6%, from the $2.92 billion originated during the year ended December 31, 2019. The increase in loan production volume was driven by a $1.18 billion, or 216.2%, increase in refinance products driven by a decrease in fixed mortgage rates. Mortgage purchase products increased $330.2 million, or 13.9% due to an increased housing demand. Total mortgage banking noninterest income increased $109.7 million, or 86.5%, to $236.7 million during the year ended December 31, 2020 compared to $126.9 million during the year ended December 31, 2019. The increase in mortgage banking noninterest income was related to a 51.6% increase in volume and an 20.2% increase in gross margin on loans originated and sold for the year ended December 31, 2020 compared to December 31, 2019. 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. The increase in gross margin on loans originated and sold reflects industry demand due to the low rate environment resulting in higher volume. 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.

Additionally, 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. Our origination efforts continue to be focused on loans made for the purpose of residential purchases, as opposed to mortgage refinance. The percentage of origination volume related to purchase activity decreased to 61.1% from 81.4% of total originations for the year ended December 31, 2020 and 2019, respectively, as refinance demand accelerated from the low rate environment. The mix of loan type trended towards more conventional loans and less governmental loans; with conventional loans and governmental loans comprising 75.8% and 24.2%, respectively of all loan originations, respectively, during the year ended December 31, 2020, compared to 69.5% and 30.5% of all originations, respectively, during the year ended December 31, 2019.

During the year ended December 31, 2020, mortgage servicing rights related to $975.9 million in loans receivable with a book value of $6.4 million were sold at a gain of $600,000. There were no sales of mortgage servicing rights during the year ended December 31, 2019.

Total compensation, payroll taxes and other employee benefits increased $35.2 million, or 41.8%, to $119.4 million for the year ended December 31, 2020 compared 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, along with an increase in bonus and incentives due to a record level of originations. In addition, branch manager pay increased as branches were more profitable due to increased volume and margin during the year. Occupancy, office furniture, and equipment expense decreased due to lower rent expense as underperforming branches closed offset by an increase in computer expenses to accommodate remote work. Advertising expense decreased as the low rate environment attracted customers. Loan processing expenses increased as loan costs increased due to loan application volume. Professional fees increased primarily due to a $4.25 million legal settlement in 2020 (see further discussion in Note 14 - Commitments, Off-Balance Sheet Arrangements, and Contingent Liabilities of the notes to consolidated financial statements for additional information) along with ongoing litigation costs. Other noninterest expense increased primarily due to increased provision for loan sale losses driven by an increase in sales volumes and increased uncertainty regarding selling loans to third party investors from COVID-19 pandemic challenges and the amortization of mortgage servicing rights as the value of the servicing portfolio has increased in 2020 compared to 2019.

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, 2020 and 2019**

| | Years Ended December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (Dollars in Thousands, except per share amounts) | |
| Net income | $ 81,145 | $ 35,903 |
| Earnings per share - basic | 3.32 | 1.38 |
| Earnings per share - diluted | 3.30 | 1.37 |
| Return on average assets | 3.77% | 1.82% |
| Return on average equity | 20.18% | 9.14% |

**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, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2020 | | | 2019 | | | 2018 | | |
| | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| | (Dollars in Thousands) | | | | | | | | |
| **Interest-earning assets:** | | | | | | | | | |
| Loans receivable and held for sale [1] | $ 1,716,341 | 72,633 | 4.23% | $ 1,546,249 | 72,235 | 4.67% | $ 1,463,730 | 66,966 | 4.58% |
| Mortgage related securities [2] | 101,345 | 2,488 | 2.45% | 113,659 | 2,978 | 2.62% | 110,136 | 2,648 | 2.40% |
| Debt securities, federal funds sold and short-term investments (2)(3) | 187,910 | 3,644 | 1.94% | 181,897 | 4,826 | 2.65% | 178,594 | 4,399 | 2.46% |
| Total interest-earning assets | 2,005,596 | 78,765 | 3.93% | 1,841,805 | 80,039 | 4.35% | 1,752,460 | 74,013 | 4.22% |
| Noninterest-earning assets | 147,697 | | | 131,168 | | | 118,737 | | |
| Total assets | $ 2,153,293 | | | $ 1,972,973 | | | $ 1,871,197 | | |
| **Interest-bearing liabilities:** | | | | | | | | | |
| Demand accounts | $ 47,410 | 38 | 0.08% | $ 36,926 | 33 | 0.09% | $ 37,388 | 33 | 0.09% |
| Money market, savings, and escrow accounts | 264,722 | 1,768 | 0.67% | 198,027 | 1,247 | 0.63% | 172,760 | 599 | 0.35% |
| Time deposits | 733,033 | 12,559 | 1.71% | 737,397 | 15,998 | 2.17% | 709,102 | 10,995 | 1.55% |
| Total interest-bearing deposits | 1,045,165 | 14,365 | 1.37% | 972,350 | 17,278 | 1.78% | 919,250 | 11,627 | 1.26% |
| Borrowings | 545,741 | 10,619 | 1.95% | 484,801 | 10,266 | 2.12% | 427,301 | 7,896 | 1.85% |
| Total interest-bearing liabilities | 1,590,906 | 24,984 | 1.57% | 1,457,151 | 27,544 | 1.89% | 1,346,551 | 19,523 | 1.45% |
| Noninterest-bearing liabilities | | | | | | | | | |
| Non-interest bearing deposits | 116,771 | | | 90,497 | | | 96,648 | | |
| Other non-interest bearing liabilities | 43,460 | | | 32,594 | | | 23,168 | | |
| Total non-interest bearing liabilities | 160,231 | | | 123,091 | | | 119,816 | | |
| Total liabilities | 1,751,137 | | | 1,580,242 | | | 1,466,367 | | |
| Equity | 402,156 | | | 392,731 | | | 404,830 | | |
| Total liabilities and equity | $ 2,153,293 | | | $ 1,972,973 | | | $ 1,871,197 | | |
| Net interest income / Net interest rate spread [4] | | 53,781 | 2.36% | | 52,495 | 2.46% | | 54,490 | 2.77% |
| Less: taxable equivalent adjustment | | 281 | 0.02% | | 298 | 0.02% | | 313 | 0.02% |
| Net interest income / Net interest rate spread, as reported | | 53,500 | 2.34% | | 52,197 | 2.44% | | 54,177 | 2.75% |
| Net interest-earning assets [5] | $ 414,690 | | | $ 384,654 | | | $ 405,909 | | |
| Net interest margin [6] | | | 2.67% | | | 2.83% | | | 3.09% |
| Tax equivalent effect | | | 0.01% | | | 0.02% | | | 0.02% |
| Net interest margin on a fully tax equivalent basis | | | 2.68% | | | 2.85% | | | 3.11% |
| Average interest-earning assets to average interest-bearing liabilities | 126.07% | | | 126.40% | | | 130.14% | | |

(1) Includes net deferred loan fee amortization income of $1.7 million, $672,000 and $622,000 for the years ended December 31, 2020, 2019, and 2018, 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, 2020, 2019, and 2018. The yields on debt securities, federal funds sold and short-term investments before tax-equivalent adjustments were 1.79%, 2.49%, and 2.29% for the years ended December 31, 2020, 2019, and 2018, 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. There were no out-of-period items or adjustments for either of the years ending December 31, 2020 or 2019.

| | Years Ended December 31, 2020 versus 2019 Increase (Decrease) due to | | | Years Ended December 31, 2019 versus 2018 Increase (Decrease) due to | | |
|---|---|---|---|---|---|---|
| | Volume | Rate | Net | Volume | Rate | Net |
| | (In Thousands) | | | | | |
| Interest and dividend income: | | | | | | |
| Loans receivable and held for sale[1] [2] | $ 7,543 | $ (7,145) | $ 398 | $ 4,045 | $ 1,224 | $ 5,269 |
| Mortgage related securities[3] | (258) | (232) | (490) | 83 | 247 | 330 |
| Other interest-earning assets[3] [4] | 154 | (1,336) | (1,182) | 79 | 348 | 427 |
| Total interest-earning assets | 7,439 | (8,713) | (1,274) | 4,207 | 1,819 | 6,026 |
| Interest expense: | | | | | | |
| Demand accounts | 9 | (4) | 5 | - | - | - |
| Money market, savings, and escrow accounts | 439 | 82 | 521 | 100 | 548 | 648 |
| Time deposits | (94) | (3,345) | (3,439) | 454 | 4,549 | 5,003 |
| Total interest-bearing deposits | 354 | (3,267) | (2,913) | 554 | 5,097 | 5,651 |
| Borrowings | 975 | (622) | 353 | 1,137 | 1,233 | 2,370 |
| Total interest-bearing liabilities | 1,329 | (3,889) | (2,560) | 1,691 | 6,330 | 8,021 |
| Net change in net interest income | $ 6,110 | $ (4,824) | $ 1,286 | $ 2,516 | $ (4,511) | $ (1,995) |

(1) Includes net deferred loan fee amortization income of $1.7 million, $672,000 and $622,000 for the years ended December 31, 2020, 2019, and 2018, 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 years ended December 31, 2020, 2019, and 2018.

**Net Interest Income**

Net interest income increased $1.3 million, or 2.5%, to $53.5 million during the year ended December 31, 2020 compared to $52.2 million during the year ended December 31, 2019.

- Interest income on loans increased $398,000 due primarily to an increase of $170.1 million, or 11.0%, in average loans offset by a 44 basis point decrease in average yield on loans as LIBOR based loans repriced and U.S. Treasury rates decreased new loan offering rates. The increase in average loan balance was driven by a $33.0 million, or 2.4%, increase in the average balance of loans held in portfolio and by an increase of $137.1 million, or 81.9%, in the average balance of loans held for sale. PPP loan fees increased interest income $480,000 for the year ended December 31, 2020.
- Interest income from mortgage-related securities decreased $490,000 primarily because the average balance of mortgage related securities decreased $12.3 million. Additionally, the average yield decreased 17 basis points.
- Interest income from other interest-earning assets (comprised of debt securities, federal funds sold and short-term investments) decreased $1.2 million due to a 70 basis point decrease in the average yield. The decrease in average yield was primarily driven by the decrease in federal funds rate earned on cash balances over the past year and matured higher yielding securities reinvested at lower rates. Offsetting the decrease in yield, the average balance increased $6.0 million to $187.9 million due to increased FHLB stock with additional FHLB borrowings and higher short-term investments. Offsetting those balance increases, the balance of municipal securities decreased as maturities occurred throughout the past 12 months and were not replaced at the same rate due to market conditions.
- Interest expense on time deposits decreased $3.4 million, or 21.5%, primarily due to a 46 basis point decrease in average cost of time deposits. Additionally, the average balance of time deposits decreased $4.4 million compared to the prior year period.

- Interest expense on money market, savings, and escrow accounts increased $521,000, or 41.8%, due primarily to an increase in average balance of $66.7 million along with a four basis point increase in average cost of money market, savings, and escrow accounts. Money market accounts have been a focus over the year and the Company has actively marketed new customers through various new offerings and new branches that opened within the past 12 months.
- Interest expense on borrowings increased $353,000, or 1.9%, due to an increase of $60.9 million to $545.7 million in average borrowing volume during the year ended December 31, 2020. The increase was primarily due to the funding of the loans held for sale. Offsetting the increase in volume, the average cost of borrowings decreased 17 basis points to 1.95% during the year ended December 31, 2020, compared to 2.12% during the year ended December 31, 2019. The decrease in the cost of borrowings resulted from the new short-term fundings borrowed at a lower rate.

**Provision for Loan Losses**

The Company delayed adoption of ASC Topic 326 as permitted under the CARES Act. As a result, the Company calculated the current year allowance using the incurred loss model. The provision for loan losses was $6.3 million for the year ended December 31, 2020 compared to a negative provision for loan losses of $900,000 for the year ended December 31, 2019 as economic conditions worsened due to the COVID-19 pandemic along with an increase of loan downgrades to our Watch category. Additional qualitative risk factors were applied to each of the loan categories primarily to account for the significant increase in the unemployment rate and those downgrades. We had a provision for loan losses of $6.1 million at the community banking segment and $265,000 for the mortgage banking segment. Net recoveries were $96,000 for the year ended December 31, 2020.

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, | | | |
|---|---|---|---|---|
| | 2020 | 2019 | $ Change | % Change |
| | (Dollars in Thousands) | | | |
| Service charges on loans and deposits | $ 4,462 | $ 2,363 | $ 2,099 | 88.8% |
| Increase in cash surrender value of life insurance | 1,905 | 1,935 | (30) | -1.6% |
| Mortgage banking income | 233,245 | 125,666 | 107,579 | 85.6% |
| Other | 4,405 | 786 | 3,619 | 460.4% |
| Total noninterest income | $ 244,017 | $ 130,750 | $ 113,267 | 86.6% |

Total noninterest income increased $113.3 million, or 86.6%, to $244.0 million during the year ended December 31, 2020 compared to $130.8 million during the year ended December 31, 2019. The increase resulted primarily from an increase in mortgage banking income along with increases in service charges on loans and deposit and other income categories.

- The $107.6 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 $1.48 billion, or 51.8%, to $4.33 billion during the year ended December 31, 2020 compared to $2.85 billion during the year ended December 31, 2019. Gross margin on loans originated and sold increased 20.2% 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, 2020 and 2019" 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 fees on existing loans and fees earned on loan swaps.
- The decrease in cash surrender value of life insurance was due primarily to a lower average balance as death benefits were received on two policies during the year.
- The increase in other noninterest income was due primarily to increases in gain from death benefit on bank owned life insurance, mortgage servicing fee income, gain on sale of mortgage servicing rights, wealth management revenue, and rental income. Mortgage servicing fee income increased as loans sold with servicing rights retained increased due to market conditions. During the year ended December 31, 2020, the Company sold mortgage servicing rights related to $975.9 million in loans receivable and with a book value of $6.4 million for $7.0 million resulting in a gain on sale of $600,000. During the year ended December 31, 2019, the Company sold no mortgage servicing rights.

**Noninterest Expenses**

| | Years Ended December 31, 2020 | Years Ended December 31, 2019 | $ Change | % Change |
|---|---|---|---|---|
| | (Dollars in Thousands) | | | |
| Compensation, payroll taxes, and other employee benefits | $ 139,046 | $ 101,718 | $ 37,328 | 36.7% |
| Occupancy, office furniture and equipment | 10,223 | 10,606 | (383) | (3.6%) |
| Advertising | 3,691 | 3,885 | (194) | (5.0%) |
| Data processing | 3,941 | 3,630 | 311 | 8.6% |
| Communications | 1,329 | 1,359 | (30) | (2.2%) |
| Professional fees | 8,118 | 3,605 | 4,513 | 125.2% |
| Real estate owned | (8) | (146) | 138 | (94.5%) |
| Loan processing expense | 4,646 | 3,288 | 1,358 | 41.3% |
| Other | 12,075 | 8,328 | 3,747 | 45.0% |
| Total noninterest expenses | $ 183,061 | $ 136,273 | $ 46,788 | 34.3% |

Total noninterest expenses increased $46.8 million, or 34.3%, to $183.1 million during the year ended December 31, 2020 compared to $136.3 million during the year ended December 31, 2019.

- Compensation, payroll taxes and other employee benefit expense at our mortgage banking segment increased $35.2 million, or 41.8%, to $119.4 million for the year ended December 31, 2020. The increase in compensation expense was primarily a result of an increase in commission expense as fundings increased and branch manager pay increased as branches were more profitable.
- Compensation, payroll taxes and other employee benefits expense at the community banking segment increased $2.0 million, or 11.2%, to $20.2 million during the year ended December 31, 2020. The increase was due primarily to an increase in salaries expense due to annual raises, health insurance expense as claims increased, and variable compensation as executives are eligible for an increased bonus. Offsetting the increases, equity award expense decreased as a majority of awards granted in 2015 had a final vesting in 2019.
- Occupancy, office furniture and equipment expense at the mortgage banking segment decreased $319,000 to $6.5 million during the year ended December 31, 2020 compared to the prior year resulting from lower rent expense as a result of underperforming branches closing. Offsetting the decreases, computer expenses increased to accommodate remote working.
- Occupancy, office furniture and equipment expense at the community banking segment decreased $64,000 to $3.7 million during the year ended December 31, 2020 compared to the prior year. The decrease was due primarily to lower computer, furniture and equipment, and snow plowing expense.
- Advertising expense decreased $315,000 at the mortgage banking segment as lower rates generated customer activity. Offsetting the decrease at the mortgage banking segment, advertising increased $121,000 at the community banking segment to promote the opening of a new branch, the release of the new digital banking platform, and additional promotions for deposit customers.
- Data processing expense increased $311,000 to $3.9 million during the year ended December 31, 2020 compared to the prior year. This was primarily due to the new digital banking platform rollout at the community banking segment and new contracts at the mortgage banking segment as technology investments continue to increase.
- Professional fees expense increased $4.5 million to $8.1 million primarily as a result of an increase in legal fees at the mortgage banking segment for a $4.25 million legal settlement (see further discussion in Note 14 - Commitments, Off-Balance Sheet Arrangements, and Contingent Liabilities of the notes to consolidated financial statements for additional information) and ongoing litigation costs. Offsetting the increase at the mortgage banking segment, the community banking segment decreased primarily due to a decrease in consulting fees.
- Loan processing expense increased $1.4 million to $4.6 million during the year ended December 31, 2020. This was primarily due to an increase in loan costs associated with the application volumes as mortgage rates declined.
- Other noninterest expense at the mortgage banking segment increased $3.6 million to $10.3 million for the year ended December 31, 2020. The increase was primarily due to an increased provision for loan sale losses as there was additional uncertainty regarding selling loans to third party investors from COVID-19 pandemic challenges. Additionally, amortization of mortgage servicing rights increased as the value of the servicing portfolio has increased in 2020 compared to 2019. Other noninterest expenses at the community banking segment increased $302,000 to $2.5 million for the year ended December 31, 2020 due primarily to loan related costs along with an increase in FDIC insurance premiums as credits were used in 2019 but were fully utilized early in 2020.

**Income Taxes**

Income tax expense increased $15.3 million to $27.0 million during the year ended December 31, 2020, compared to $11.7 million during the year ended December 31, 2019 as pretax income increased $60.5 million. Income tax expense was recognized during the year ended December 31, 2020 at an effective rate of 24.9% compared to an effective rate of 24.5% during the year ended December 31, 2019. The Company recognized a benefit of $354,000 related to the proceeds received on the bank owned life insurance death benefit during the year ended December 31, 2020.

**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, 2020 were 12.2% and 23.1%, 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, 2020 and 2019, $94.8 million and $74.3 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, 2020, and 2019, we originated $4.33 billion and $2.85 billion in loans for sale and sold loans of $4.40 billion and $2.90 billion. During the year ended December 31, 2020, loan repayments net of loan originations resulted in a positive cash flows of $12.4 million, respectively. During the year ended December 31, 2019, loan originations net of loan repayments resulted in a negative cash flows of $9.9 million. Cash received from the principal repayments of debt and mortgage related securities and maturity and calls of debt securities totaled $50.5 million and $40.0 million for the years ended December 31, 2020 and 2019, respectively. We purchased $29.5 million and $28.9 million in debt securities and mortgage related securities classified as available for sale during the years ended December 31, 2020 and 2019, respectively. The net increases in deposits were $117.1 million and $29.3 million for the years ending December 31, 2020 and 2019. We received a $9.6 million death benefit on a bank owned life insurance policy in 2020. There was a net increase in borrowings of $24.5 million and $48.5 million for the years ended December 31, 2020 and 2019. During the years ended December 31, 2020 and 2019, we repurchased common stock of $36.2 million and $22.8 million, respectively. During the years ended December 31, 2020 and 2019, we paid cash dividends on common stock of $31.5 million and $26.0 million, respectively.

Deposits increased by $117.1 million from December 31, 2019 to December 31, 2020. The increase was driven by an increase of $97.4 million in money market and savings deposits and $58.2 million in demand deposits offset by a decrease of $38.4 million in time 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, 2020, we had $29.0 million in short term advances from the FHLB. At December 31, 2020, 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. There are two 2028 advances that have contractual maturities in 2028. The remaining 2028 advance maturities have single call options in March 2021, 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 options currently available and the other options that began in November 2020, beginning in August 2021, and beginning in May 2022. As an additional source of funds, the mortgage banking segment has a repurchase agreement. At December 31, 2020, we had $9.1 million outstanding under the repurchase agreement with a total outstanding commitment of $55.0 million.

At December 31, 2020, we had outstanding commitments to originate loans receivable of $23.9 million. In addition, at December 31, 2020, we had unfunded commitments under construction loans of $74.2 million, unfunded commitments under business lines of credit of $19.2 million and unfunded commitments under home equity lines of credit and standby letters of credit of $14.9 million. At December 31, 2020, certificates of deposit scheduled to mature in less than one year totaled $576.9 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.

**Capital**

Shareholders’ equity increased by $19.4 million, or 4.9%, to $413.1 million at December 31, 2020 from $393.7 million at December 31, 2019. Shareholders' equity increased primarily due to net income, additional paid-in capital as stock options were exercised and equity awards vested, an increase in fair value of the security portfolio, and unearned ESOP shares vesting. Partially offsetting the increases, there were decreases due to the declaration of regular and special dividends and the repurchase of stock.

The Company's Board of Directors authorized a stock repurchase program in the third quarter of 2020. As of December 31, 2020, the Company had repurchased 10.7 million shares at an average price of $14.39 under previously approved stock repurchase plans.

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, 2020, Waterstone Financial, Inc. and WaterStone Bank exceeded all regulatory capital requirements and are considered “well capitalized” under regulatory guidelines. See “Supervision and Regulation—Capital Requirements” and Note 9 - Regulatory Capital of the notes to the consolidated financial statements.

**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, 2020 and the respective maturity dates.

**Contractual Obligations**

| | Total | One Year or Less | More Than One Year Through Three Years | More Than Three Years Through Five Years | Over Five Years |
|---|---|---|---|---|---|
| | | | (In Thousands) | | |
| Deposits without a stated maturity [1] | $ 483,542 | $ 483,542 | $ - | $ - | $ - |
| Time deposit [1] | 701,328 | 576,939 | 122,116 | 2,273 | - |
| Repurchase agreements [1] | 9,074 | 9,074 | - | - | - |
| Federal Home Loan Bank advances [2] | 499,000 | 29,000 | - | - | 470,000 |
| Operating leases [3] | 8,819 | 2,894 | 3,559 | 1,470 | 896 |
| Total Contractual Obligations | $ 1,701,763 | $ 1,101,449 | $ 125,675 | $ 3,743 | $ 470,896 |

(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**

| | Total | One Year or Less | More than One Year through Three Years | More than Three Years Through Five Years | Over Five Years |
|---|---|---|---|---|---|
| | | | (In Thousands) | | |
| Real estate loan commitments[1] | $ 23,891 | $ 23,891 | $ - | $ - | $ - |
| Unused portion of home equity lines of credit[2] | 13,653 | 13,653 | - | - | - |
| Unused portion of construction loans[3] | 74,173 | 74,173 | - | - | - |
| Unused portion of business lines of credit | 19,207 | 19,207 | - | - | - |
| Standby letters of credit | 1,296 | 1,296 | - | - | - |

_______________

(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) | | | |
| **2020 (unaudited)** | | | | |
| Interest income | $ 19,452 | $ 19,861 | $ 19,544 | $ 19,627 |
| Interest expense | 6,926 | 6,612 | 6,135 | 5,311 |
| Net interest income | 12,526 | 13,249 | 13,409 | 14,316 |
| Provision for loan losses | 785 | 4,500 | 1,025 | 30 |
| Net interest income after provision for loan losses | 11,741 | 8,749 | 12,384 | 14,286 |
| Total noninterest income | 31,464 | 66,904 | 75,763 | 69,886 |
| Total noninterest expense | 35,208 | 47,689 | 53,001 | 47,163 |
| Income before income taxes | 7,997 | 27,964 | 35,146 | 37,009 |
| Income taxes | 1,928 | 7,016 | 8,853 | 9,174 |
| Net income | $ 6,069 | $ 20,948 | $ 26,293 | $ 27,835 |
| Income per share – basic | $ 0.24 | $ 0.86 | $ 1.08 | $ 1.17 |
| Income per share - diluted | $ 0.24 | $ 0.85 | $ 1.08 | $ 1.17 |
| | | | | |
| **2019 (unaudited)** | | | | |
| 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 |

**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, 2020 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** |
| | (Dollar Amounts in Thousands) | | | |
| As of December 31, 2020 | | | | |
| Dollar Change | $ 4,958 | $ 4,525 | $ 2,502 | $ (2,784) |
| Percentage Change | 8.58% | 7.83 | 4.33 | (4.82) |

At December 31, 2020, a 100 basis point instantaneous increase in interest rates had the effect of increasing forecast net interest income over the next 12 months by 4.33% while a 100 basis point decrease in rates had the effect of decreasing net interest income by 4.82%.

**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, 2020 and 2019, 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, 2020, 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, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020, 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, 2020, 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 1, 2021 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.

**Critical Audit Matter**

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

***Allowance for Loan Losses - Adjustments to historical loss ratios***

As described in Notes 1 and 3 to the consolidated financial statements, the Company’s allowance for loan losses totaled $18,823,000, which consists of a reserve on loans collectively evaluated for impairment (“general reserve”) of $18,800,000 and a reserve on loans individually evaluated for impairment (“specific reserve”) of $23,000 at December 31, 2020. Management’s estimate of the allowance for loan losses is based on its assessment of probable loan losses inherent in the Company’s loan portfolio at December 31, 2020. The Company’s general reserve is estimated by applying historical loss ratios, adjusted for risk components not reflected in the historical loss experience, to the balance of the non-impaired loan portfolio. Historical loss ratios are calculated for each loan category based on historical losses experienced by the Company. Adjustments to historical loss ratios are made for differences in various risk components including changes in lending policies and personnel, economic conditions, portfolio origination activity, interest rates, and past due and classified loan trends. The adjustments to historical loss ratios require a significant amount of judgement by management and are highly sensitive to changes in significant assumptions.

We identified the adjustments to historical loss ratios in the general reserve component of the allowance for loan losses as a critical audit matter as auditing the underlying adjustments required significant auditor judgment as amounts determined by management rely on analysis that is highly subjective and are highly sensitive to changes in significant assumptions.

Our audit procedures related to the adjustments to historical loss ratios in the general reserve component of the allowance for loan losses included the following, among others:

- We obtained an understanding of the allowance for loan loss methodology and relevant controls related to the adjustments to historical loss ratios in the calculation of the allowance for loan losses and tested such controls for design and operating effectiveness, including the completeness and accuracy of information used in management’s assessment, and its challenge and review of the adjustments to historical loss ratios.
- We tested the completeness and accuracy of data used by management in determining adjustments to historical loss ratios by agreeing this data to internal and external source data
- We tested management’s conclusions regarding the appropriateness of the adjustments to historical loss ratios by challenging assumptions and rationale for the adjustments in total, both in magnitude and directional consistency, with underlying data used and for consistency with the Company’s policies.

/s/ RSM US LLP

We have served as the Company's auditor since 2014.

Chicago, Illinois
March 1, 2021

**Waterstone Financial, Inc. and Subsidiaries**
**Consolidated Statements of Financial Condition**
**December 31, 2020 and 2019**

| | December 31, | |
|---|---|---|
| | **2020** | **2019** |
| **Assets** | (In Thousands, except share data) | |
| Cash | $ 56,190 | $ 52,814 |
| Federal funds sold | 18,847 | 12,704 |
| Interest-earning deposits in other financial institutions and other short term investments | 19,730 | 8,782 |
| Cash and cash equivalents | 94,767 | 74,300 |
| Securities available for sale (at fair value) | 159,619 | 178,476 |
| Loans held for sale (at fair value) | 402,003 | 220,123 |
| Loans receivable | 1,375,137 | 1,388,031 |
| Less: Allowance for loan losses | 18,823 | 12,387 |
| Loans receivable, net | 1,356,314 | 1,375,644 |
| | | |
| Office properties and equipment, net | 23,722 | 25,028 |
| Federal Home Loan Bank stock (at cost) | 26,720 | 21,150 |
| Cash surrender value of life insurance | 63,573 | 69,665 |
| Real estate owned, net | 322 | 748 |
| Prepaid expenses and other assets | 57,547 | 31,213 |
| Total assets | $ 2,184,587 | $ 1,996,347 |
| | | |
| **Liabilities and Shareholders' Equity** | | |
| Liabilities: | | |
| Demand deposits | $ 188,225 | $ 130,063 |
| Money market and savings deposits | 295,317 | 197,942 |
| Time deposits | 701,328 | 739,771 |
| Total deposits | 1,184,870 | 1,067,776 |
| | | |
| Borrowings | 508,074 | 483,562 |
| Advance payments by borrowers for taxes | 3,522 | 4,212 |
| Other liabilities | 75,003 | 47,111 |
| Total liabilities | 1,771,469 | 1,602,661 |
| Commitments and contingencies (Note 14) | | |
| | | |
| Shareholders' equity: | | |
| Preferred stock (par value $0.01 per share) Authorized - 50,000,000 shares in 2020 and 2019, no shares issued | - | - |
| Common stock (par value $0.01 per share) Authorized - 100,000,000 shares in 2020 and 2019 Issued - 25,087,976 in 2020 and 27,148,411 in 2019 Outstanding - 25,087,976 in 2020 and 27,148,411 in 2019 | 251 | 271 |
| Additional paid-in capital | 180,684 | 211,997 |
| Retained earnings | 245,287 | 197,393 |
| Unearned ESOP shares | (15,430) | (16,617) |
| Accumulated other comprehensive income, net of taxes | 2,326 | 642 |
| Total shareholders' equity | 413,118 | 393,686 |
| Total liabilities and shareholders' equity | $ 2,184,587 | $ 1,996,347 |

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**
**Consolidated Statements of Operations**
**Years ended December 31, 2020, 2019 and 2018**

| | Years ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| | (In Thousands, except per share amounts) | | |
| Interest income: | | | |
| Loans | $ 72,633 | $ 72,235 | $ 66,966 |
| Mortgage-related securities | 2,488 | 2,978 | 2,648 |
| Debt securities, federal funds sold and short-term investments | 3,363 | 4,528 | 4,086 |
| Total interest income | 78,484 | 79,741 | 73,700 |
| Interest expense: | | | |
| Deposits | 14,365 | 17,278 | 11,627 |
| Borrowings | 10,619 | 10,266 | 7,896 |
| Total interest expense | 24,984 | 27,544 | 19,523 |
| Net interest income | 53,500 | 52,197 | 54,177 |
| Provision (credit) for loan losses | 6,340 | (900) | (1,060) |
| Net interest income after provision for loan losses | 47,160 | 53,097 | 55,237 |
| Noninterest income: | | | |
| Service charges on loans and deposits | 4,462 | 2,363 | 1,680 |
| Increase in cash surrender value of life insurance | 1,905 | 1,935 | 1,848 |
| Mortgage banking income | 233,245 | 125,666 | 113,151 |
| Other | 4,405 | 786 | 1,520 |
| Total noninterest income | 244,017 | 130,750 | 118,199 |
| Noninterest expenses: | | | |
| Compensation, payroll taxes, and other employee benefits | 139,046 | 101,718 | 97,784 |
| Occupancy, office furniture, and equipment | 10,223 | 10,606 | 10,855 |
| Advertising | 3,691 | 3,885 | 4,123 |
| Data processing | 3,941 | 3,630 | 2,792 |
| Communications | 1,329 | 1,359 | 1,611 |
| Professional fees | 8,118 | 3,605 | 2,327 |
| Real estate owned | (8) | (146) | 1 |
| Loan processing expense | 4,646 | 3,288 | 3,372 |
| Other | 12,075 | 8,328 | 10,291 |
| Total noninterest expenses | 183,061 | 136,273 | 133,156 |
| Income before income taxes | 108,116 | 47,574 | 40,280 |
| Income tax expense | 26,971 | 11,671 | 9,526 |
| Net income | $ 81,145 | $ 35,903 | $ 30,754 |
| Income per share: | | | |
| Basic | $ 3.32 | $ 1.38 | $ 1.12 |
| Diluted | $ 3.30 | $ 1.37 | $ 1.11 |
| Weighted average shares outstanding: | | | |
| Basic | 24,464 | 26,021 | 27,363 |
| Diluted | 24,607 | 26,247 | 27,634 |

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**
**Consolidated Statements of Comprehensive Income**
**Years ended December 31, 2020, 2019 and 2018**

| | Years ended December 31, | | |
|---|---|---|---|
| | **2020** | **2019** | **2018** |
| | | (In Thousands) | |
| Net income | $ 81,145 | $ 35,903 | $ 30,754 |
| 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 ($630), ($1,122) and $710 respectively | 1,684 | 3,003 | (1,889) |
| Recognition of net deferred tax liability revaluation due to tax law change | - | - | 5 |
| Total other comprehensive income (loss) | 1,684 | 3,003 | (1,884) |
| Comprehensive income | $ 82,829 | $ 38,906 | $ 28,870 |

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**
**Consolidated Statements of Changes in Shareholders' Equity**
**Years Ended December 31, 2020, 2019 and 2018**

| | Common Stock | | | | | | |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Additional Paid-In Capital | Retained Earnings | Unearned ESOP Shares | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
| Balances at December 31, 2017 | 29,501 | $ 295 | $ 247,919 | $ 183,358 | (18,991) | $ (477) | $ 412,104 |
| Comprehensive income: | | | | | | | |
| 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 |
| Comprehensive income: | | | | | | | |
| 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 |
| Comprehensive income: | | | | | | | |
| Net income | - | $ - | - | 81,145 | - | - | 81,145 |
| Other comprehensive income: | - | - | - | - | - | 1,684 | 1,684 |
| Total comprehensive income | | | | | | | 82,829 |
| ESOP shares committed to be released to Plan participants | - | - | 489 | - | 1,187 | - | 1,676 |
| Cash dividends, $1.36 per share | - | - | - | (33,251) | - | - | (33,251) |
| Stock compensation activity | 293 | 3 | 3,701 | - | - | - | 3,704 |
| Stock based compensation expense | - | - | 716 | - | - | - | 716 |
| Purchase of common stock returned to authorized but unissued | (2,353) | (23) | (36,219) | - | - | - | (36,242) |
| Balances at December 31, 2020 | 25,088 | $ 251 | $ 180,684 | $ 245,287 | (15,430) | $ 2,326 | $ 413,118 |

*See accompanying notes to consolidated financial statements*

**Waterstone Financial, Inc. and Subsidiaries**
**Consolidated Statements of Cash Flows**
**Years ended December 31, 2020, 2019 and 2018**

| | Years ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| | | (In Thousands) | |
| **Operating activities:** | | | |
| Net income | $ 81,145 | $ 35,903 | $ 30,754 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | | |
| Provision (credit) for loan losses | 6,340 | (900) | (1,060) |
| Depreciation, amortization, accretion | 5,606 | 4,698 | 4,727 |
| Deferred income taxes | (2,620) | 639 | 535 |
| Stock based compensation | 716 | 1,067 | 1,760 |
| Origination of mortgage servicing rights | (13,406) | (354) | (427) |
| Gain on sale of loans held for sale | (245,358) | (128,928) | (109,526) |
| Loans originated for sale | (4,332,028) | (2,853,222) | (2,509,827) |
| Proceeds on sales of loans originated for sale | 4,395,505 | 2,903,643 | 2,627,634 |
| Gain on death benefit on bank owned life insurance | (1,456) | - | - |
| Decrease (increase) in accrued interest receivable | 387 | (7) | (413) |
| Increase in cash surrender value of life insurance | (1,905) | (1,935) | (1,848) |
| (Decrease) increase in accrued interest on deposits and borrowings | (422) | 164 | 509 |
| Decrease (increase) in prepaid income tax | 113 | 330 | (1,178) |
| Net gain on real estate owned | (107) | (304) | (265) |
| Gain on sale of mortgage servicing rights | (600) | - | (417) |
| Change in other assets and other liabilities, net | 7,523 | (1,013) | 545 |
| Net cash (used in) provided by operating activities | (100,567) | (40,219) | 41,503 |
| | | | |
| **Investing activities:** | | | |
| Net decrease (increase) in loans receivable | 12,353 | (9,896) | (87,648) |
| Net change in FHLB Stock | (5,570) | (1,800) | (2,475) |
| Purchases of: | | | |
| Debt securities | (10,125) | - | - |
| Mortgage related securities | (19,372) | (28,860) | (28,058) |
| Premises and equipment, net | (1,225) | (3,114) | (3,962) |
| Bank owned life insurance | (180) | (180) | (180) |
| Mortgage banking branch | - | - | (163) |
| Proceeds from: | | | |
| Principal repayments on mortgage-related securities | 45,254 | 31,944 | 28,572 |
| Maturities of debt securities | 5,290 | 8,080 | 10,435 |
| Proceeds on sales of mortgage servicing rights | 6,985 | - | 1,433 |
| Death benefit from bank owned life insurance | 9,633 | - | 474 |
| Sales of real estate owned | 1,133 | 2,674 | 3,134 |
| Net cash provided by (used in) investing activities | 44,176 | (1,152) | (78,438) |
| | | | |
| **Financing activities:** | | | |
| Net increase in deposits | 117,094 | 29,281 | 71,115 |
| Net change in short term borrowings | 24,512 | 8,516 | (41,239) |
| Repayment of long term debt | - | (125,000) | (165,000) |
| Proceeds from long term debt | - | 165,000 | 255,000 |
| Net decrease in advance payments by borrowers for taxes | (690) | (159) | (505) |
| Cash dividends on common stock | (31,520) | (25,960) | (27,050) |
| Proceeds from stock option exercises | 3,704 | 659 | 1,304 |
| Purchase of common stock returned to authorized but unissued | (36,242) | (22,767) | (19,196) |
| Net cash provided by financing activities | 76,858 | 29,570 | 74,429 |
| Increase (decrease) in cash and cash equivalents | 20,467 | (11,801) | 37,494 |
| Cash and cash equivalents at beginning of year | 74,300 | 86,101 | 48,607 |
| Cash and cash equivalents at end of year | $ 94,767 | $ 74,300 | $ 86,101 |
| | | | |
| **Supplemental information:** | | | |
| Cash paid or credited during the period for: | | | |
| Income tax payments | $ 29,478 | $ 10,703 | $ 10,168 |
| Interest payments | 25,406 | 27,380 | 19,014 |
| Noncash investing activities: | | | |
| Loans receivable transferred to other real estate | 637 | 1,052 | 545 |
| Dividends declared but not paid in other liabilities | 5,232 | 3,501 | 3,798 |

*See accompanying notes to consolidated financial statements*

## 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 reclassed certain line items in the Consolidated Statements of Cash Flows. 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. 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 76.0% of total mortgage banking noninterest expense for 2020.

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.

The provisions of the CARES Act included an election to not apply the guidance on accounting for troubled debt restructurings to loan modifications, such as extensions or deferrals, related to COVID-19 made between March 1, 2020 and the earlier of (i) December 31, 2020 or (ii) 60 days after the end of the COVID-19 national emergency. The relief can only be applied to modifications for borrowers that were not more than 30 days past due as of December 31, 2019. In December 2020, the Consolidated Appropriations Act, 2021 was passed, which extended the TDR provisions of the CARES Act to January 1, 2022. The Company elected to adopt these provisions of the CARES Act.

***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 lending policies and personnel, economic conditions, portfolio origination activity, interest rates, and past due and classified loan trends.

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 in the consolidated statements of financial condition. 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 polices 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 consolidated statements of operations.

***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*

*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.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law. It included an option for entities to delay the adoption of ASC Topic 326 until the earlier of the termination date of the national emergency declaration by the President or December 31, 2020. Due to the uncertainty on the economy and unemployment from COVID-19, the Company has determined to delay its adoption of ASC Topic 326 and has calculated and recorded its provision for loan losses under the incurred loss model that existed prior to ASC Topic 326. On December 27, 2020, the 2021 Consolidated Appropriations Act was signed into law. The legislation extended the delay of the adoption of ASC Topic 326 allowed under the CARES Act until the earlier of the termination date of the national emergency declaration by the President or January 1, 2022.

The Company has input the available historical Company data to build an internal model and is reviewing the assumptions to support the calculation under ASC Topic 326. Management's methodology for estimating the allowance for credit losses under the current expected credit losses (CECL) model 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.

When finalized, this one-time change as a result of the adoption of CECL will be recorded, net of tax, as an adjustment to retained earnings effective on the earlier of the termination date of the national emergency declaration by the President or January 1, 2022.

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.

As we continue to evaluate the provisions of ASC Topic 326 as of and for the year ended December 31, 2020, we are considering the following in developing our forecast and its effect on our CECL calculations:

- Duration, extent and severity of COVID-19;
- Effect of government assistance; and
- Unemployment and effect on economies and markets.

## 2) Securities

### Securities Available for Sale

The amortized cost and fair value of the Company's investment in securities follow:

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| | (In Thousands) | | | |
| Mortgage-backed securities | $ 24,005 | $ 1,110 | $ (15) | $ 25,100 |
| Collateralized mortgage obligations | | | | |
| Government sponsored enterprise issued | 61,604 | 1,693 | (13) | 63,284 |
| Private-label issued | 3,611 | 54 | - | 3,665 |
| Mortgage related securities | 89,220 | 2,857 | (28) | 92,049 |
| | | | | |
| Government sponsored enterprise bonds | 2,500 | 3 | - | 2,503 |
| Municipal securities | 51,512 | 2,102 | - | 53,614 |
| Other debt securities | 12,500 | 46 | (1,093) | 11,453 |
| Debt securities | 66,512 | 2,151 | (1,093) | 67,570 |
| | | | | |
| | $ 155,732 | $ 5,008 | $ (1,121) | $ 159,619 |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| | (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 |
| | | | | |
| | $ 176,903 | $ 2,993 | $ (1,420) | $ 178,476 |

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, 2020, $785,000 of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities and $7.2 million were pledged as collateral to secure back-to-back swaps. 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, 2020, 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.

| | December 31, 2020 | |
|---|---|---|
| | Amortized cost | Fair value |
| | (In Thousands) | |
| Debt securities: | | |
| Due within one year | $ 6,934 | $ 6,992 |
| Due after one year through five years | 36,309 | 37,520 |
| Due after five years through ten years | 18,146 | 17,808 |
| Due after ten years | 5,123 | 5,250 |
| Mortgage-related securities | 89,220 | 92,049 |
| | $ 155,732 | $ 159,619 |

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:

| | December 31, 2020 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair value | Unrealized loss | Fair value | Unrealized loss | Fair value | Unrealized loss |
| | (In Thousands) | | | | | |
| Mortgage-backed securities | $ 2,089 | $ (15) | $ - | $ - | $ 2,089 | $ (15) |
| Collateralized mortgage obligations | | | | | | |
| Government sponsored enterprise issued | 4,880 | (13) | - | - | 4,880 | (13) |
| Municipal securities | - | - | - | - | - | - |
| Other debt securities | - | - | 8,907 | (1,093) | 8,907 | (1,093) |
| | $ 6,969 | $ (28) | $ 8,907 | $ (1,093) | $ 15,876 | $ (1,121) |

| | December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or longer | | Total | |
| | Fair value | Unrealized loss | Fair value | Unrealized loss | Fair value | Unrealized loss |
| | (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) |
| | $ 24,752 | $ (157) | $ 18,909 | $ (1,263) | $ 43,661 | $ (1,420) |

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, 2020, 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, 2020, 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, 2020, the Company had one corporate debt security, included in other debt securities, which had been in an unrealized loss position for twelve months or longer. This security was determined not to be other-than-temporarily impaired as of December 31, 2020. 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, this security is 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.

### 3) Loans Receivable

Loans receivable at December 31, 2020 and 2019 are summarized as follows:

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| | (In Thousands) | |
| Mortgage loans: | | |
| Residential real estate: | | |
| One- to four-family | $ 426,792 | $ 480,280 |
| Multi family | 571,948 | 584,859 |
| Home equity | 14,820 | 18,071 |
| Construction and land | 77,080 | 37,033 |
| Commercial real estate | 238,375 | 236,703 |
| Consumer | 736 | 832 |
| Commercial loans | 45,386 | 30,253 |
| Total loans receivable | $ 1,375,137 | $ 1,388,031 |

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 73.7% 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 were pledged as collateral against $499.0 million and $470.0 million in outstanding Federal Home Loan Bank of Chicago advances under a blanket security agreement at December 31, 2020 and December 31, 2019, respectively.

Certain of the Company's executive officers, directors, employees, and their related interests have loans with the Bank. As of December 31, 2020 and December 31, 2019, loans aggregating approximately $7.2 million and $6.3 million, respectively, were outstanding to such parties. None of these loans were past due or considered impaired as of December 31, 2020 and December 31, 2019.

An analysis of past due loans receivable as of December 31, 2020 and 2019 follows:

| | As of December 31, 2020 | | | | | |
|---|---|---|---|---|---|---|
| | 1-59 Days Past Due (1) | 60-89 Days Past Due (2) | 90 Days or Greater Past Due | Total Past Due | Current (3) | Total Loans |
| | (In Thousands) | | | | | |
| Mortgage loans: | | | | | | |
| Residential real estate: | | | | | | |
| One- to four-family | $ 3,796 | $ 142 | $ 3,530 | $ 7,468 | $ 419,324 | $ 426,792 |
| Multi family | - | - | 314 | 314 | 571,634 | 571,948 |
| Home equity | - | - | 30 | 30 | 14,790 | 14,820 |
| Construction and land | - | - | 43 | 43 | 77,037 | 77,080 |
| Commercial real estate | - | - | 41 | 41 | 238,334 | 238,375 |
| Consumer | - | - | - | - | 736 | 736 |
| Commercial loans | - | - | - | - | 45,386 | 45,386 |
| Total | $ 3,796 | $ 142 | $ 3,958 | $ 7,896 | $ 1,367,241 | $ 1,375,137 |

| | As of December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | 1-59 Days Past Due (1) | 60-89 Days Past Due (2) | 90 Days or Greater Past Due | Total Past Due | Current (3) | Total Loans |
| | (In Thousands) | | | | | |
| Mortgage loans: | | | | | | |
| 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 |

(1) Includes $611,000 and $53,000 for December 31, 2020 and 2019, respectively, which are on non-accrual status.
(2) Includes $- and $291,000 for December 31, 2020 and 2019, respectively, which are on non-accrual status.
(3) Includes $1.6 million and $2.0 million for December 31, 2020 and 2019, respectively, which are on non-accrual status.

As of December 31, 2020, there was a $586,000 loan that was 90 or more days past due and still accruing interest. The bank received full payoff of the loan subsequent to December 31, 2020. As of December 31, 2019, 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 December 31, 2020, 2019 and 2018 in the allowance for loan losses follows:

| | One- to Four-Family | Multi Family | Home Equity | Construction and Land | Commercial Real Estate | Consumer | Commercial | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (In Thousands) | | | | |
| Year ended December 31, 2020 | | | | | | | | |
| Balance at beginning of period | $ 4,907 | $ 4,138 | $ 201 | $ 610 | $ 2,145 | $ 14 | $ 372 | $ 12,387 |
| Provision (credit) for loan losses | 486 | 1,446 | (21) | 1,151 | 2,977 | 31 | 270 | 6,340 |
| Charge-offs | (82) | (5) | (13) | (8) | - | (10) | - | (118) |
| Recoveries | 148 | 21 | 27 | 2 | 16 | - | - | 214 |
| Balance at end of period | $ 5,459 | $ 5,600 | $ 194 | $ 1,755 | $ 5,138 | $ 35 | $ 642 | $ 18,823 |
| 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 | $ 4,907 | $ 4,138 | $ 201 | $ 610 | $ 2,145 | $ 14 | $ 372 | $ 12,387 |
| 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 | $ 5,742 | $ 4,153 | $ 325 | $ 400 | $ 2,126 | $ 20 | $ 483 | $ 13,249 |

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, 2020 follows:

| | One- to Four-Family | Multi Family | Home Equity | Construction and Land | Commercial Real Estate | Consumer | Commercial | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (In Thousands) | | | | |
| Allowance related to loans individually evaluated for impairment | $ 23 | $ - | $ - | $ - | $ - | $ - | $ - | $ 23 |
| Allowance related to loans collectively evaluated for impairment | 5,436 | 5,600 | 194 | 1,755 | 5,138 | 35 | 642 | 18,800 |
| Balance at end of period | $ 5,459 | $ 5,600 | $ 194 | $ 1,755 | $ 5,138 | $ 35 | $ 642 | $ 18,823 |
| Loans individually evaluated for impairment | $ 7,805 | $ 341 | $ 63 | $ 43 | $ 7,248 | $ - | $ 1,097 | $ 16,597 |
| Loans collectively evaluated for impairment | 418,987 | 571,607 | 14,757 | 77,037 | 231,127 | 736 | 44,289 | 1,358,540 |
| Total gross loans | $ 426,792 | $ 571,948 | $ 14,820 | $ 77,080 | $ 238,375 | $ 736 | $ 45,386 | $ 1,375,137 |

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:

| | One- to Four-Family | Multi Family | Home Equity | Construction and Land | Commercial Real Estate | Consumer | Commercial | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | (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 | $ 4,907 | $ 4,138 | $ 201 | $ 610 | $ 2,145 | $ 14 | $ 372 | $ 12,387 |
| 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 | $ 480,280 | $ 584,859 | $ 18,071 | $ 37,033 | $ 236,703 | $ 832 | $ 30,253 | $ 1,388,031 |

The following table presents information relating to the Company's internal risk ratings of its loans receivable as of December 31, 2020 and 2019:

| | One- to Four-Family | Multi Family | Home Equity | Construction and Land | Commercial Real Estate | Consumer | Commercial | Total |
|---|---|---|---|---|---|---|---|---|
| At December 31, 2020 | | | | (In Thousands) | | | | |
| Substandard | $ 7,804 | $ 341 | $ 248 | $ 43 | $ 6,026 | $ - | $ 710 | $ 15,172 |
| Watch | 7,667 | 275 | 15 | 4,282 | 6,714 | - | 4,101 | 23,054 |
| Pass | 411,321 | 571,332 | 14,557 | 72,755 | 225,635 | 736 | 40,575 | 1,336,911 |
| | $ 426,792 | $ 571,948 | $ 14,820 | $ 77,080 | $ 238,375 | $ 736 | $ 45,386 | $ 1,375,137 |
| At December 31, 2019 | | | | (In Thousands) | | | | |
| 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 |
| | $ 480,280 | $ 584,859 | $ 18,071 | $ 37,033 | $ 236,703 | $ 832 | $ 30,253 | $ 1,388,031 |

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 except for residential loans which has an approval limit in excess of $1.0 million. 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 multi 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, 2020 and 2019.

| | As of or for the Year Ended December 31, 2020 | | | | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal | Reserve | Cumulative Charge-Offs | Average Recorded Investment | Interest Paid YTD |
| Total Impaired with Reserve | | | | | | |
| One- to four-family | $ 208 | $ 208 | $ 23 | $ - | $ 213 | $ 15 |
| Multi family | - | - | - | - | - | - |
| Home equity | - | - | - | - | - | - |
| Construction and land | - | - | - | - | - | - |
| Commercial real estate | - | - | - | - | - | - |
| Consumer | - | - | - | - | - | - |
| Commercial | - | - | - | - | - | - |
| | $ 208 | $ 208 | $ 23 | $ - | $ 213 | $ 15 |
| Total Impaired with no Reserve | | | | | | |
| One- to four-family | $ 7,597 | $ 8,444 | $ - | $ 847 | $ 7,770 | $ 349 |
| Multi family | 341 | 352 | - | 11 | 353 | 17 |
| Home equity | 63 | 63 | - | - | 67 | 4 |
| Construction and land | 43 | 51 | - | 8 | 51 | 1 |
| Commercial real estate | 7,248 | 7,248 | - | - | 7,295 | 333 |
| Consumer | - | - | - | - | - | - |
| Commercial | 1,097 | 1,097 | - | - | 1,097 | 2 |
| | $ 16,389 | $ 17,255 | $ - | $ 866 | $ 16,633 | $ 706 |
| Total Impaired | | | | | | |
| One- to four-family | $ 7,805 | $ 8,652 | $ 23 | $ 847 | $ 7,983 | $ 364 |
| Multi family | 341 | 352 | - | 11 | 353 | 17 |
| Home equity | 63 | 63 | - | - | 67 | 4 |
| Construction and land | 43 | 51 | - | 8 | 51 | 1 |
| Commercial real estate | 7,248 | 7,248 | - | - | 7,295 | 333 |
| Consumer | - | - | - | - | - | - |
| Commercial | 1,097 | 1,097 | - | - | 1,097 | 2 |
| | $ 16,597 | $ 17,463 | $ 23 | $ 866 | $ 16,846 | $ 721 |

| | As of or for the Year Ended December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal | Reserve | Cumulative Charge-Offs | Average Recorded Investment | Interest Paid YTD |
| Total Impaired with Reserve | | | | | | |
| 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 | - | - | - | - | - | - |
| | $ 224 | $ 633 | $ 39 | $ 409 | $ 231 | $ 15 |
| Total Impaired with no Reserve | | | | | | |
| 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 | - | - | - | - | - | - |
| | $ 9,833 | $ 11,680 | $ - | $ 1,847 | $ 10,170 | $ 616 |
| Total Impaired | | | | | | |
| 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 | - | - | - | - | - | - |
| | $ 10,057 | $ 12,313 | $ 39 | $ 2,256 | $ 10,401 | $ 631 |

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 $16.4 million of impaired loans as of December 31, 2020 for which no allowance has been provided, $866,000 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, 2020 | | | | | |
|---|---|---|---|---|---|---|
| | Accruing | | Non-accruing | | Total | |
| | Amount | Number | Amount | Number | Amount | Number |
| | (Dollars in Thousands) | | | | | |
| One- to four-family | $ 2,733 | 2 | $ 532 | 3 | $ 3,265 | 5 |
| Multi family | - | - | - | - | - | - |
| Commercial real estate | 7,207 | 3 | - | - | 7,207 | 3 |
| Commercial | 1,097 | 1 | - | - | 1,097 | 1 |
| | $ 11,037 | 6 | $ 532 | 3 | $ 11,569 | 9 |

| | 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 |
| | $ 3,018 | 3 | $ 1,000 | 8 | $ 4,018 | 11 |

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 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, 2020, $11.6 million in loans had been modified in troubled debt restructurings and $532,000 of these loans were included in the non-accrual loan total. The remaining $11.0 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, no valuation allowance has been deemed necessary as of December 31, 2020 with respect to the $11.6 million in troubled debt restructurings. As of December 31, 2019, $7,000 in valuation allowance had been established with respect to the $4.0 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, 2020 and 2019:

| | As of December 31, 2020 | | | | | |
|---|---|---|---|---|---|---|
| | Performing in accordance with modified terms | | In Default | | Total | |
| | Amount | Number | Amount | Number | Amount | Number |
| | (Dollars in Thousands) | | | | | |
| Interest reduction and principal forbearance | $ 3,236 | 4 | $ - | - | $ 3,236 | 4 |
| Interest reduction | 302 | 2 | - | - | 302 | 2 |
| Principal forbearance | 8,031 | 3 | - | - | 8,031 | 3 |
| | $ 11,569 | 9 | $ - | - | $ 11,569 | 9 |

| | As of December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Performing in accordance with modified terms | | In Default | | Total | |
| | Amount | Number | Amount | Number | Amount | Number |
| | (Dollars in Thousands) | | | | | |
| Interest reduction and principal forbearance | $ 3,246 | 6 | $ 448 | 2 | $ 3,694 | 8 |
| Interest reduction | 324 | 3 | - | - | 324 | 3 |
| | $ 3,570 | 9 | $ 448 | 2 | $ 4,018 | 11 |

The following presents data on troubled debt restructurings:

| | For the Year Ended | | | |
|---|---|---|---|---|
| | December 31, 2020 | | December 31, 2019 | |
| | Amount | Number | Amount | Number |
| | (Dollars in Thousands) | | | |
| Loans modified as a troubled debt restructure | | | | |
| Commercial real estate | $ 8,031 | 3 | $ - | - |
| | $ 8,031 | 3 | $ - | - |

There were no troubled debt restructurings within the past twelve months for which there was a default during the year ended December 31, 2020.

The provisions of the CARES Act and the 2021 Consolidated Appropriations Act included an election to not apply the guidance on accounting for troubled debt restructurings to loan modifications, such as extensions or deferrals, related to COVID-19 made between March 1, 2020 and the earlier of (i) January 1, 2022 or (ii) 60 days after the end of the COVID-19 national emergency. The relief can only be applied to modifications for borrowers that were not more than 30 days past due as of December 31, 2019. The Company elected to adopt these provisions of the CARES Act. At December 31, 2020, the Company had approximately $1.2 million in outstanding loans subject to interest and principal and principal deferral agreements.

The following table presents data on non-accrual loans:

| | As of December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (Dollars in Thousands) | |
| Residential | | |
| One- to four-family | $ 5,072 | $ 5,985 |
| Multi family | 341 | 667 |
| Home equity | 63 | 70 |
| Construction and land | 43 | - |
| Commercial real estate | 41 | 303 |
| Commercial | - | - |
| Consumer | - | - |
| Total non-accrual loans | $ 5,560 | $ 7,025 |
| | | |
| Total non-accrual loans to total loans | 0.40% | 0.51% |
| Total non-accrual loans to total assets | 0.25% | 0.35% |

## 4) Office Properties and Equipment

Office properties and equipment are summarized as follows:

| | December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (In Thousands) | |
| Land | $ 7,516 | $ 7,516 |
| Office buildings and improvements | 34,923 | 34,433 |
| Furniture and equipment | 13,517 | 13,468 |
| | 55,956 | 55,417 |
| Less accumulated depreciation | (32,234) | (30,389) |
| | $ 23,722 | $ 25,028 |

Depreciation of premises and equipment totaled $2.5 million, $2.5 million and $2.3 million for the years ended December 31, 2020, 2019 and 2018, respectively.

## 5) Real Estate Owned

Real estate owned is summarized as follows:

| | December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (In Thousands) | |
| One- to four-family | $ - | $ 46 |
| Multi-family | - | - |
| Construction and land | 322 | 1,256 |
| Commercial real estate | - | - |
| Total | 322 | 1,302 |
| Valuation allowance at end of period | - | (554) |
| Total real estate owned, net | $ 322 | $ 748 |

The following table presents the activity in real estate owned:

| | Year Ended December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (In Thousands) | |
| Real estate owned at beginning of period | $ 748 | $ 2,152 |
| Transferred in from loans receivable | 637 | 1,052 |
| Sales | (1,063) | (2,446) |
| Write downs | - | - |
| Other activity | - | (10) |
| Real estate owned at end of period | $ 322 | $ 748 |

Residential one- to four-family mortgage loans that were in the process of foreclosure were $1.7 million and $2.3 million at December 31, 2020 and December 31, 2019, respectively.

## 6) Mortgage Servicing Rights

The following table presents the activity related to the Company's mortgage servicing rights:

| | Year ended December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (In Thousands) | |
| Mortgage servicing rights at beginning of the period | $ 282 | $ 109 |
| Additions | 13,406 | 354 |
| Amortization | (1,326) | (104) |
| Sales | (6,385) | - |
| Mortgage servicing rights at end of the period | 5,977 | 359 |
| Valuation allowance during the period | - | (77) |
| Mortgage servicing rights at the end of the period, net | $ 5,977 | $ 282 |

During the year ended December 31, 2020, on a consolidated basis, $4.33 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 $4.15 billion, generating mortgage banking income of $233.2 million. The unpaid principal balance of loans serviced for others was $871.8 million and $64.9 million at December 31, 2020 and December 31, 2019 respectively. Loans serviced for others are not reflected in the consolidated statements of financial condition.

The fair value of mortgage servicing rights was $7.0 million at December 31, 2020 and $282,000 at December 31, 2019.

During the year ended December 31, 2020, the Company sold mortgage servicing rights related to $975.9 million in loans receivable and with a book value of $6.4 million for $7.0 million resulting in a gain on sale of $600,000. During the year ended December 31, 2019, the Company sold no mortgage servicing rights.

The following table shows the estimated future amortization expense for mortgage servicing rights at December 31, 2020 for the years ended December 31 periods indicated:

| | (In Thousands) |
|---|---|
| 2021 | $ 1,195 |
| 2022 | 850 |
| 2023 | 798 |
| 2024 | 691 |
| 2025 | 587 |
| Thereafter | 1,856 |
| Total | $ 5,977 |

## 7) Deposits

The aggregate amount of time deposit accounts with balances greater than $250,000 at December 31, 2020 and 2019 amounted to $102.6 million and $91.7 million, respectively.

A summary of interest expense on deposits is as follows:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| | | (In Thousands) | |
| Interest-bearing demand deposits | $ 38 | $ 33 | $ 33 |
| Money market, savings, and escrow deposits | 1,768 | 1,247 | 599 |
| Time deposits | 12,559 | 15,998 | 10,995 |
| | $ 14,365 | $ 17,278 | $ 11,627 |

A summary of the contractual maturities of time deposits at December 31, 2020 is as follows:

| | (In Thousands) |
|---|---|
| Within one year | $ 576,939 |
| One to two years | 106,407 |
| Two to three years | 15,709 |
| Three to four years | 1,057 |
| Four through five years | 1,216 |
| | $ 701,328 |

## 8) Borrowings

Borrowings consist of the following:

| | December 31, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| | Balance | Weighted Average Rate | Balance | Weighted Average Rate |
| | (Dollars in Thousands) | | | |
| Short term: | | | | |
| Repurchase agreement | $ 9,074 | 3.25% | $ 13,562 | 4.66% |
| Federal Home Loan Bank, Chicago | 29,000 | 0.22% | - | 0.00% |
| | | | | |
| Long term: | | | | |
| Federal Home Loan Bank advances maturing: | | | | |
| 2027 | 50,000 | 1.73% | 50,000 | 1.73% |
| 2028 | 255,000 | 2.37% | 255,000 | 2.37% |
| 2029 | 165,000 | 1.61% | 165,000 | 1.61% |
| | $ 508,074 | 1.95% | $ 483,562 | 2.11% |

The short-term repurchase agreement represents the outstanding portion of a total $55.0 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 $9.1 million balance at December 31, 2020 and a $13.6 million balance at December 31, 2019.

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. In addition, 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 financial condition, while the securities and loans held for sale underlying the repurchase agreements remain in the respective investment securities and loans held for sale asset accounts. In other words, there is no offsetting or netting of the investment securities or loans held for sale assets with the repurchase agreement liabilities. The Company's repurchase agreement is 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 $29.0 million short-term advances consists of one $25.0 million advance with a fixed rate of 0.25% and a maturity date of January 4, 2021 and one $4.0 million advance with a fixed rate of 0.00% and a maturity date of May 1, 2021.

The $50.0 million advance 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%, one $25.0 million advance with a fixed rate of 2.40%, two advances totaling $55.0 million with a fixed rate of 2.27% both with a FHLB single call option in March 2021, two advances totaling $50.0 million with fixed rates of 2.34% and 2.48% both 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 currently available, and one advance of $50.0 million with a fixed rate of 2.57% and with a FHLB quarterly call option that currently available.

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 beginning in August 2021, one $25.0 million advance with a fixed rate of 1.52% with a FHLB quarterly call option currently available, and one advance of $40.0 million with a fixed rate of 1.02% and with a FHLB quarterly call option currently available.

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 $26.7 million at December 31, 2020 and $21.2 million at December 31, 2019. 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.

As required by applicable legislation, the federal banking agencies were required to develop a "Community Bank Leverage Ratio" (the ratio of a bank's tangible equity capital to average total consolidated assets) for financial institutions with assets of less than $10 billion. A "qualifying community bank" that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered "well capitalized" under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution's risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement.

The federal banking agencies must set the minimum capital for the new Community Bank Leverage Ratio at not less than 8% and not more than 10%. Beginning in the second quarter 2020 and until the end of the year, a banking organization that has a leverage ratio of 8% or greater and meets certain other criteria may elect to use the Community Bank Leverage Ratio framework; and qualified community banks will have until January 1, 2022, before the Community Bank Leverage Ratio requirement is re-established at greater than 9%. Pursuant to Section 4012 of the CARES Act and related interim final rules, the Community Bank Leverage Ratio will be 8% beginning in the second quarter and for the remainder of calendar year 2020, 8.5% for calendar year 2021, and 9% thereafter. A financial institution can elect to be subject to this new definition, and opt-out of this new definition, at any time. As a qualified community bank, we elected to opt-out of this definition during the second quarter of 2020.

Prompt corrective action regulations provide five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If only adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

The minimum capital ratios set forth in the Regulatory Capital Plans will be increased and other minimum capital requirements will be established if and as necessary. In accordance with the Regulatory Capital Plans, the Bank will not pursue any acquisition or growth opportunity, declare any dividend or conduct any stock repurchase that would cause the Bank's total risk-based capital ratio and/or its Tier 1 leverage ratio to fall below the established minimum capital levels or the capital levels required for capital adequacy plus the capital conservation buffer. The minimum capital conservation buffer is 2.5%.

As of December 31, 2020, the Bank was well-capitalized, with all capital ratios exceeding the well-capitalized requirement. There are no conditions or events that management believes have changed the Bank's prompt corrective action capitalization category.

The Bank is subject to regulatory restrictions on the amount of dividends it may declare and pay to the Company without prior regulatory approval, and to regulatory notification requirements for dividends that do not require prior regulatory approval.

The actual and required capital amounts and ratios as of December 31, 2020 and 2019 are presented in the table below:

| | December 31, 2020 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Actual | | For Capital Adequacy Purposes | | Minimum Capital Adequacy with Capital Buffer | | To Be Well-Capitalized Under Prompt Corrective Action Provisions | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (Dollars In Thousands) | | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | | | |
| Consolidated Waterstone Financial, Inc. | $ 428,972 | 24.80% | $ 138,390 | 8.00% | $ 181,637 | 10.500% | $ N/A | N/A |
| WaterStone Bank | 389,519 | 22.52% | 138,346 | 8.00% | 181,579 | 10.500% | 172,933 | 10.00% |
| Tier I capital (to risk-weighted assets) | | | | | | | | |
| Consolidated Waterstone Financial, Inc. | 410,149 | 23.71% | 103,792 | 6.00% | 147,039 | 8.500% | N/A | N/A |
| WaterStone Bank | 370,696 | 21.44% | 103,760 | 6.00% | 146,993 | 8.500% | 138,346 | 8.00% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | | | | | | | | |
| Consolidated Waterstone Financial, Inc. | 410,149 | 23.71% | 77,844 | 4.50% | 121,091 | 7.000% | N/A | N/A |
| WaterStone Bank | 370,696 | 21.44% | 77,820 | 4.50% | 121,053 | 7.000% | 112,406 | 6.50% |
| Tier I capital (to average assets) | | | | | | | | |
| Consolidated Waterstone Financial, Inc. | 410,149 | 18.38% | 89,238 | 4.00% | N/A | N/A | N/A | N/A |
| WaterStone Bank | 370,696 | 16.61% | 89,263 | 4.00% | N/A | N/A | 111,579 | 5.00% |
| State of Wisconsin (to total assets) | | | | | | | | |
| WaterStone Bank | 370,696 | 16.62% | 133,856 | 6.00% | N/A | N/A | N/A | N/A |

| | December 31, 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | (Dollars In Thousands) | | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | | | |
| Consolidated Waterstone Financial, Inc. | $ 404,748 | 26.17% | $ 123,731 | 8.00% | $ 162,398 | 10.50% | $ N/A | N/A |
| WaterStone Bank | 353,357 | 22.85% | 123,716 | 8.00% | 162,378 | 10.50% | 154,646 | 10.00% |
| Tier I capital (to risk-weighted assets) | | | | | | | | |
| Consolidated Waterstone Financial, Inc. | 392,361 | 25.37% | 92,799 | 6.00% | 131,465 | 8.50% | N/A | N/A |
| WaterStone Bank | 340,970 | 22.05% | 92,787 | 6.00% | 131,449 | 8.50% | 123,716 | 8.00% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | | | | | | | | |
| Consolidated Waterstone Financial, Inc. | 392,361 | 25.37% | 69,599 | 4.50% | 108,265 | 7.00% | N/A | N/A |
| WaterStone Bank | 340,970 | 22.05% | 69,590 | 4.50% | 108,252 | 7.00% | 100,520 | 6.50% |
| Tier I capital (to average assets) | | | | | | | | |
| 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% |
| State of Wisconsin (to total assets) | | | | | | | | |
| WaterStone Bank | 340,970 | 17.11% | 119,590 | 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 was equal to the quoted NASDAQ market closing price on the date that the awards were granted and the stock options 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. The exercise price for all stock options granted was 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.

In 2020, both the 2006 and 2015 Omnibus Incentive Plans were terminated and the 2020 Equity Incentive Plan was approved. A total of 750,000 stock options and 500,000 restricted shares were approved for award. A total of 720,000 stock options and 500,000 restricted stock were available to be issued as of December 31, 2020.

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 represents 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, 2020 and 2019.

| | 2020 | | 2019 | |
|---|---|---|---|---|
| | Minimum | Maximum | Minimum | Maximum |
| Dividend yield | 2.59% | 3.76% | 2.56% | 2.92% |
| Risk-free interest rate | 0.28% | 0.40% | 1.42% | 2.28% |
| Expected volatility | 18.91% | 22.58% | 16.07% | 16.37% |
| Weighted average expected life | 5.6 | 5.8 | 5.0 | 5.8 |
| Weighted average per share value of options | $ 1.11 | $ 2.64 | $ 1.72 | $ 2.12 |

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, 2020, 2019 and 2018 is presented below.

| Stock Options | Shares | Weighted Average Exercise Price | Weighted Average Years Remaining in Contractual Term | Aggregate Intrinsic Value (000's) |
|---|---|---|---|---|
| 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 |
| | | | | |
| Granted | 35,000 | 16.06 | | 97 |
| Exercised | (291,944) | 12.66 | | 1,799 |
| Forfeited | (17,000) | 17.17 | | 28 |
| Outstanding December 31, 2020 | 751,827 | 13.57 | 4.82 | 3,945 |
| Options exercisable at December 31, 2020 | 433,827 | 13.31 | 4.45 | 2,392 |

The following table summarizes information about the Company's stock options outstanding at December 31, 2020.

| | Options Outstanding | Weighted Average Exercise Price | Remaining Life (Years) | Options Exercisable | Weighted Average Exercise Price | Remaining Life (Years) |
|---|---|---|---|---|---|---|
| Range of Exercise Prices | | | | | | |
| $0.01 - $5.00 | 3,427 | $ 1.73 | 1.88 | 3,427 | $ 1.73 | 1.88 |
| $5.01 - $10.00 | - | - | - | - | - | - |
| $10.01 - $15.00 | 628,400 | 12.84 | 4.34 | 384,400 | 12.85 | 4.23 |
| Over $15.01 | 120,000 | 17.62 | 7.43 | 46,000 | 17.70 | 6.46 |
| | 751,827 | $ 13.57 | 4.82 | 433,827 | $ 13.31 | 4.45 |

The following table summarizes information about the Company’s nonvested stock option activity for the years ended December 31, 2020 and 2019:

| **Stock Options** | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| 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 | 479,001 | 3.24 |
| | | |
| Nonvested at December 31, 2019 | 479,001 | 3.24 |
| Granted | 35,000 | 2.06 |
| Vested | (179,001) | 3.26 |
| Forfeited | (17,000) | 2.21 |
| Nonvested at December 31, 2020 | 318,000 | 3.16 |

The Company amortizes the expense related to stock options as compensation expense over the vesting period. Expense for the stock options granted of $398,000, $582,000 and $608,000 was recognized during the years ended December 31, 2020, 2019 and 2018, respectively. At December 31, 2020, the Company had $744,000 in estimated unrecognized compensation costs related to outstanding stock options that is expected to be recognized over a weighted average period of 20 months.

The following table summarizes information about the Company’s restricted stock shares activity for the years ended December 31, 2020 and 2019:

| **Restricted Stock** | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested at December 31, 2018 | 162,600 | $ 12.85 |
| Granted | - | - |
| Vested | (89,600) | 12.84 |
| Forfeited | - | - |
| Nonvested at December 31, 2019 | 73,000 | 12.86 |
| | | |
| Nonvested at December 31, 2019 | 73,000 | 12.86 |
| Granted | - | - |
| Vested | (27,000) | 13.06 |
| Forfeited | - | - |
| Nonvested at December 31, 2020 | 46,000 | 12.75 |

The Company amortizes the expense related to restricted stock awards as compensation expense over the vesting period. Expense for the restricted stock awards of $318,000, $486,000 and $1.2 million was recorded for the years ended December 31, 2020, 2019 and 2018, respectively. At December 31, 2020, the Company had $311,000 of unrecognized compensation expense related to restricted stock shares that is expected to be recognized over a weighted average period of 13 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 $1.4 million, $1.0 million and $971,000 to the plans during the years ended December 31, 2020, 2019 and 2018, respectively.

## 12) Employee Stock Ownership Plan

All WaterStone Bank 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 $1.8 million, respectively, for the years ended December 31, 2020, 2019 and 2018.

The aggregate activity in the number of unearned ESOP shares, considering the allocation of those shares committed to be released as of December 31, 2020 and 2019 is as follows:

| | 2020 | 2019 |
|---|---|---|
| Beginning ESOP shares | 1,475,293 | 1,580,671 |
| Shares committed to be released | (105,378) | (105,378) |
| Unreleased shares | 1,369,915 | 1,475,293 |
| Fair value of unreleased shares (in millions) | $ 25.8 | $ 28.1 |

## 13) Income Taxes

The provision for income taxes for the year ended December 31, 2020, 2019 and 2018 consists of the following:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| | | (In Thousands) | |
| Current: | | | |
| Federal | $ 22,272 | $ 8,377 | $ 7,087 |
| State | 7,319 | 2,655 | 1,904 |
| | 29,591 | 11,032 | 8,991 |
| Deferred: | | | |
| Federal | (2,171) | 619 | 452 |
| State | (449) | 20 | 83 |
| | (2,620) | 639 | 535 |
| Total | $ 26,971 | $ 11,671 | $ 9,526 |

The income tax provisions differ from that computed at the Federal statutory corporate tax rate for the years ended December 31, 2020, 2019 and 2018 as follows:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| | (Dollars In Thousands) | | |
| Income before income taxes | $ 108,116 | $ 47,574 | $ 40,280 |
| Tax at Federal statutory rate (21% in 2020, 2019, and 2018) | 22,704 | 9,991 | 8,459 |
| Add (deduct) effect of: | | | |
| State income taxes net of Federal income tax benefit | 5,428 | 2,113 | 1,570 |
| Cash surrender value of life insurance | (400) | (406) | (388) |
| Non-deductible ESOP and stock option expense | 133 | 186 | 188 |
| Tax-exempt interest income | (222) | (236) | (248) |
| Non-deductible compensation | 96 | 216 | 177 |
| Death benefit on bank owned life insurance | (306) | - | - |
| Stock compensation | (387) | (312) | (313) |
| Other | (75) | 119 | 81 |
| Income tax provision | $ 26,971 | 11,671 | 9,526 |
| Effective tax rate | 24.9% | 24.5% | 23.6% |

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, 2020 and 2019:

| | December 31, | |
|---|---|---|
| | 2020 | 2019 |
| Gross deferred tax assets: | (In Thousands) | |
| Depreciation | $ 832 | - |
| Restricted stock and stock options | 312 | 440 |
| Allowance for loan losses | 4,682 | 3,031 |
| Repurchase reserve for loans sold | 765 | 244 |
| Non-accrual interest | 208 | 262 |
| Real estate owned | 166 | 305 |
| Litigation | 1,206 | - |
| Unrealized loss on impaired securities | 23 | 23 |
| Lease liability | 1,855 | 2,170 |
| Other | 49 | 32 |
| Total gross deferred tax assets | 10,098 | 6,507 |
| Gross deferred tax liabilities: | | |
| Depreciation | - | (80) |
| Unrealized gain on securities available for sale, net | (1,059) | (429) |
| Mortgage servicing rights | (1,558) | (75) |
| FHLB stock dividends | (52) | (51) |
| Lease asset | (1,726) | (2,053) |
| Deferred loan fees | (300) | (406) |
| Deferred liabilities | (4,695) | (3,094) |
| Net deferred tax assets | $ 5,403 | $ 3,413 |

The Company had a Wisconsin net operating loss carry forward of $20,000 at December 31, 2020 which will begin to expire in 2028. The Company has no capital loss carryforwards as of December 31, 2020.

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, 2020 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 2016 or subject to federal tax examinations for the years before 2017.

**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.

| | December 31, | |
|---|---|---|
| | 2020 | 2019 |
| | (In Thousands) | |
| Financial instruments whose contract amounts represent potential credit risk: | | |
| Commitments to extend credit under first mortgage loans[1] | $ 23,891 | $ 13,389 |
| Commitments to extend credit under home equity lines of credit | 13,653 | 13,776 |
| Unused portion of construction loans | 74,173 | 90,439 |
| Unused portion of business lines of credit | 19,207 | 14,623 |
| Standby letters of credit | 1,296 | 885 |

**(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, 2020 and 2019.

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 these 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 could be required if defined delinquency issues arose during the limited recourse period. Given that the underlying loans delivered to buyers are predominantly conventional first lien mortgages, historical experience has resulted in insignificant losses and repurchase activity. The Company's reserve for losses related to these recourse provisions that is reported as a component of other liabilities on the Company's consolidated statement of financial condition totaled $2.9 million and $921,000 as of December 31, 2020 and December 31, 2019, respectively.

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 $7.3 million in damages to Claimants, $3.3 million in attorney fees and costs, and a $20,000 incentive fee to Plaintiff Herrington.

Subsequently, the Seventh Circuit Court of Appeals issued a ruling in October 2018 vacating the District Court's order enforcing the arbitration award, 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. The arbitrator issued a written award on February 18, 2020 in which he found Waterstone liable for damages, awarding Herrington $14,952 in damages on her claims. On May 6, 2020, the arbitrator issued an award that would allow Herrington to recover $1.1 million in attorney fees and costs. As a result of that award, the Company recorded a loss reserve with respect to this matter for $1.1 million during the three months ended March 31, 2020.

*Various Claimants v. Waterstone Mortgage Corporation*

Subsequent to the aforementioned decision by the United States District Court for the Western District of Wisconsin, which ruled that claims brought forth under the Herrington class action lawsuit must be resolved through single-plaintiff arbitration, 95 of the prior claimants in the aforementioned class action lawsuit filed new demands in arbitration asserting similar claims ("the Arbitrations"). Waterstone answered the arbitration demands and denied the allegations.

*Raeleen Johnson v. Waterstone*

Subsequent to the aforementioned decision by the United States District Court for the Western District of Wisconsin vacating the prior collective award, on May 3, 2019, Raeleen Johnson and 38 other Loan Originators who were prior Claimants in the Herrington Arbitration also filed a claim in the Eastern District of Wisconsin, in the United States District Court for the Eastern District of Wisconsin, Johnson et al. v. Waterstone Mortgage Corporation. The Johnson action claimed that Waterstone Mortgage Corporation violated the FLSA by failing to pay loan officers minimum and overtime wages. They also alleged that Waterstone breached its contractual agreement regarding their compensation. The Johnson action was pleaded as a class and collective action, brought on behalf of Johnson and other Waterstone loan originators. Johnson did not move for certification of her claims, and in August 2020, the Court issued an order finding that since no motion for certification had been filed, the case would not proceed as a class action. Ultimately, this case was limited to 30 plaintiffs.

*Resolution of Claims*

In September 2020, the parties reached a tentative agreement to resolve all of the above claims, including the Herrington individual arbitration and resulting $1.1 million award, the Arbitrations, and the Raeleen Johnson action. The proposed settlement payment was $4.25 million in total, which fully resolved all of the alleged claims and all attorney fees and costs. The parties finalized the terms of the settlement in November 2020. The global settlement was submitted to the arbitrator and approved in December 2020. As a result, the Company recorded a loss reserve with respect to this matter for $4.25 million during the year ended and as of December 31, 2020. The expense related to this reserve is reflected in Professional Fees in the Consolidated Statements of Operations. The Company funded the settlement on February 5, 2021 and these matters are now closed.

## 15) Derivative Financial Instruments

### Mortgage Banking Derivatives

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, 2020, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of $779.9 million and interest rate lock commitments with an aggregate notional amount of approximately $486.2 million. The fair value of the forward commitments to sell mortgage loans at December 31, 2020 included a loss of $5.1 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, 2020 included a gain of $11.1 million that is reported as a component of other assets on the Company's consolidated statements of financial condition. 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.

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.

The significant unobservable input used in the fair value measurement of the Company's mortgage banking derivatives, including interest rate lock commitments, is the loan pull through rate. This represents the percentage of loans currently in a lock position which the Company estimates will ultimately close. Generally, the fair value of an interest rate lock commitment will be positively (negatively) impacted when the prevailing interest rate is lower (higher) than the interest rate lock commitment. Generally, an increase in the pull through rate will result in the fair value of the interest rate lock increasing when in a gain position, or decreasing when in a loss position. The pull through rate is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. The pull through rate is computed using historical data and the ratio is periodically reviewed by the Company.

**Interest Rate Swaps**

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 through back-to-back swaps. 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.

The aggregate amortizing notional value of back-to-back swaps with various commercial borrowers was $107.5 million at December 31, 2020 and $30.9 million at December 31, 2019. The Company receives fixed rates and pays floating rates based upon LIBOR on the swaps with commercial borrowers. These swaps mature in December 2029 to June 2037. 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 $3.9 million as of December 31, 2020 and $680,000 as of December 31, 2019. As of December 31, 2020 and December 31, 2019, no back-to-back swaps were in default.

The aggregate amortizing notional value of back-to-back swaps with dealer counterparties was $107.5 million as of December 31, 2020 and $30.9 million as of December 31, 2019. The Company pays fixed rates and receives floating rates based upon LIBOR on the swaps with dealer counterparties. These swaps' maturity dates range from December 2029 to June 2037. 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 $3.9 million as of December 31, 2020 and $680,000 as of December 31, 2019. No right of offset existed with dealer counterparty swaps as of December 31, 2020 and December 31, 2019.

All changes in the fair value of these instruments are recorded in other non-interest income. The Company pledged $7.2 million in mortgage backed securities to secure its obligation under these contracts at December 31, 2020 and $710,000 in cash at December 31, 2019.

**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, 2020 and December 31, 2019, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

| | December 31, 2020 | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 |
| | | (In Thousands) | | |
| **Assets** | | | | |
| Available for sale securities | | | | |
| Mortgage-backed securities | $ 25,100 | $ - | $ 25,100 | $ - |
| Collateralized mortgage obligations | | | | |
| Government sponsored enterprise issued | 63,284 | - | 63,284 | - |
| Private-label issued | 3,665 | - | 3,665 | - |
| Government sponsored enterprise bonds | 2,503 | - | 2,503 | - |
| Municipal securities | 53,614 | - | 53,614 | - |
| Other debt securities | 11,453 | - | 11,453 | - |
| Loans held for sale | 402,003 | - | 402,003 | - |
| Mortgage banking derivative assets | 11,057 | - | - | 11,057 |
| Interest rate swap assets | 3,892 | - | 3,892 | - |
| **Liabilities** | | | | |
| Mortgage banking derivative liabilities | 5,140 | - | - | 5,140 |
| Interest rate swap liabilities | 3,892 | - | 3,892 | - |

| | December 31, 2019 | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 |
| | | (In Thousands) | | |
| **Assets** | | | | |
| 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 | - |
| **Liabilities** | | | | |
| Mortgage banking derivative liabilities | - | - | - | - |
| Interest rate swap liabilities | 680 | - | 680 | - |

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 values 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 values of municipal and other debt securities are 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 2020 and 2019.

| | Mortgage banking derivatives, net |
|---|---|
| Balance at December 31, 2018 | $ 898 |
| Transfer into level 3 | - |
| Mortgage derivative gain, net | 937 |
| Balance at December 31, 2019 | 1,835 |
| Transfer into level 3 | - |
| Mortgage derivative gain, net | 4,082 |
| Balance at December 31, 2020 | $ 5,917 |

***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, 2020 and December 31, 2019, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

| | **December 31, 2020** | **Fair Value Measurements Using** | | |
|---|---|---|---|---|
| | | **Level 1** | **Level 2** | **Level 3** |
| | | (In Thousands) | | |
| Impaired loans, net (1) | $ 185 | $ - | $ - | $ 185 |
| Real estate owned | 322 | - | - | 322 |
| Impaired mortgage servicing rights | 189 | - | - | 189 |

| | **December 31, 2019** | **Fair Value Measurements Using** | | |
|---|---|---|---|---|
| | | **Level 1** | **Level 2** | **Level 3** |
| | | (In Thousands) | | |
| Impaired loans, net (1) | $ 185 | $ - | $ - | $ 185 |
| Real estate owned | 748 | - | - | 748 |
| Impaired mortgage servicing rights | 206 | - | - | 206 |

_________

(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, 2020, loans determined to be impaired with an outstanding balance of $208,000 were carried net of specific reserves of $23,000 for a fair value of $185,000. 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. 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 writedowns during the years ended December 31, 2020 and 2019, respectively. At December 31, 2020 and December 31, 2019, real estate owned totaled $322,000 and $748,000, 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, 2020 and 2019, there was $77,000 of impairment on 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, 2020 | Valuation Technique | Significant Unobservable Inputs | Significant Unobservable Input Value | | |
|---|---|---|---|---|---|---|
| | | | | Minimum Value | Maximum Value | Weighted Average |
| Mortgage banking derivatives | $ 5,917 | Pricing models | Pull through rate | 5.0% | 99.9% | 88.0% |
| Impaired loans | 185 | Market approach | Discount rates applied to appraisals | 15.0% | 15.0% | 15.0% |
| Real estate owned | 322 | Market approach | Discount rates applied to appraisals | 34.8% | 51.0% | 44.6% |
| Mortgage servicing rights | 7,075 | Pricing models | Prepayment rate | 11.3% | 37.9% | 12.7% |
| | | | Discount rate | 9.5% | 14.0% | 10.6% |
| | | | Cost to service | $ 76.98 | $ 475.26 | 84.85 |

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, 2020 and December 31, 2019:

| | December 31, 2020 | | | | | December 31, 2019 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Carrying amount | Fair Value | | | | Carrying amount | Fair Value | | | |
| | | Total | Level 1 | Level 2 | Level 3 | | Total | Level 1 | Level 2 | Level 3 |
| | (In Thousands) | | | | | | | | | |
| **Financial Assets** | | | | | | | | | | |
| Cash and cash equivalents | $ 94,767 | $ 94,767 | $ 94,767 | $ - | $ - | $ 74,300 | $ 74,300 | $ 65,800 | $ 8,500 | $ - |
| Securities available-for-sale | 159,619 | 159,619 | - | 159,619 | - | 178,476 | 178,476 | - | 178,476 | - |
| Loans held for sale | 402,003 | 402,003 | - | 402,003 | - | 220,123 | 220,123 | - | 220,123 | - |
| Loans receivable | 1,375,137 | 1,374,898 | - | - | 1,374,898 | 1,388,031 | 1,426,224 | - | - | 1,426,224 |
| FHLB stock | 26,720 | 26,720 | - | 26,720 | - | 21,150 | 21,150 | - | 21,150 | - |
| Accrued interest receivable | 4,957 | 4,957 | 4,957 | - | - | 5,344 | 5,344 | 5,344 | - | - |
| Mortgage servicing rights | 5,977 | 7,075 | - | - | 7,075 | 282 | 282 | - | - | 282 |
| Mortgage banking derivative assets | 11,057 | 11,057 | - | - | 11,057 | 1,835 | 1,835 | - | - | 1,835 |
| Interest rate swap assets | 3,892 | 3,892 | - | 3,892 | - | 680 | 680 | - | 680 | - |
| **Financial Liabilities** | | | | | | | | | | |
| Deposits | 1,184,870 | 1,186,062 | 483,542 | 702,520 | - | 1,067,776 | 1,070,083 | 328,005 | 742,078 | - |
| Advance payments by borrowers for taxes | 3,522 | 3,522 | 3,522 | - | - | 4,212 | 4,212 | 4,212 | - | - |
| Borrowings | 508,074 | 545,107 | - | 545,107 | - | 483,562 | 483,846 | - | 483,846 | - |
| Accrued interest payable | 1,137 | 1,137 | 1,137 | - | - | 1,559 | 1,559 | 1,559 | - | - |
| Mortgage banking derivative liabilities | 5,140 | 5,140 | - | - | 5,140 | - | - | - | - | - |
| Interest rate swap liabilities | 3,892 | 3,892 | - | 3,892 | - | 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, 2020 and December 31, 2019.

***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.

There were 125,000, 118,000, and 95,000 antidilutive shares of common stock for the years ended December 31, 2020, 2019, and 2018, respectively.

Presented below are the calculations for basic and diluted earnings per share:

| | For the year ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| | (In Thousands, except per share amounts) | | |
| Net income | $ 81,145 | $ 35,903 | $ 30,754 |
| Weighted average shares outstanding | 24,464 | 26,021 | 27,363 |
| Effect of dilutive potential common shares | 143 | 226 | 271 |
| Diluted weighted average shares outstanding | $ 24,607 | $ 26,247 | $ 27,634 |
| Basic income per share | $ 3.32 | $ 1.38 | $ 1.12 |
| Diluted income per share | $ 3.30 | $ 1.37 | $ 1.11 |

## 18) Condensed Parent Company Only Statements

### Statements of Financial Condition

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| | (In Thousands) | |
| **Assets** | | |
| Cash and cash equivalents | $ 44,386 | $ 54,730 |
| Investment in subsidiaries | 373,665 | 342,295 |
| Other assets | 304 | 187 |
| Total Assets | $ 418,355 | $ 397,212 |
| | | |
| **Liabilities and shareholders' equity** | | |
| Liabilities: | | |
| Other liabilities | $ 5,237 | $ 3,526 |
| Shareholders' equity | | |
| Preferred Stock (par value $0.01 per share), Authorized - 50,000,000 shares in 2020 and 2019, no shares issued | - | - |
| Common stock (par value $0.01 per share), Authorized - 100,000,000 shares in 2020 and in 2019, Issued - 25,087,976 in 2020 and 27,148,411 in 2019, Outstanding - 25,087,976 in 2020 and 27,148,411 in 2019 | 251 | 271 |
| Additional paid-in-capital | 180,684 | 211,997 |
| Retained earnings | 245,287 | 197,393 |
| Unearned ESOP shares | (15,430) | (16,617) |
| Accumulated other comprehensive gain (net of taxes) | 2,326 | 642 |
| Total shareholders' equity | 413,118 | 393,686 |
| Total liabilities and shareholders' equity | $ 418,355 | $ 397,212 |

### Statements of Operations

| | For the year ended December 31, 2020 | 2019 | 2018 |
|---|---|---|---|
| | | (In Thousands) | |
| Interest income | $ 688 | $ 793 | $ 656 |
| Equity in income of subsidiaries (distributed and undistributed) | 81,122 | 35,784 | 30,722 |
| Total income | 81,810 | 36,577 | 31,378 |
| | | | |
| Professional fees | 47 | 58 | 37 |
| Other expense | 610 | 577 | 577 |
| Total expense | 657 | 635 | 614 |
| | | | |
| Income before income tax expense | 81,153 | 35,942 | 30,764 |
| | | | |
| Income tax expense | 8 | 39 | 10 |
| Net income | $ 81,145 | $ 35,903 | $ 30,754 |

**Statements of Cash Flows**

| | For the year ended December 31, | | |
|---|---|---|---|
| | 2020 | 2019 | 2018 |
| | | (In Thousands) | |
| Cash flows from operating activities | | | |
| Net income | $ 81,145 | $ 35,903 | $ 30,754 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Amortization of unearned ESOP | 1,676 | 1,805 | 1,796 |
| Stock based compensation | 716 | 1,067 | 1,760 |
| Equity in earnings of subsidiaries | (81,122) | (35,784) | (30,722) |
| Change in other assets and liabilities | (853) | 1,235 | (4,019) |
| Net cash provided by (used in) operating activities | 1,562 | 4,226 | (431) |
| Net cash used in investing activities | - | - | - |
| Dividends received from subsidiary | 52,152 | 78,456 | 36,535 |
| Cash dividends on common stock | (31,520) | (25,960) | (27,050) |
| Proceeds from stock option exercises | 3,704 | 659 | 1,304 |
| Purchase of common stock returned to authorized but unissued | (36,242) | (22,767) | (19,196) |
| Net cash (used in) provided by financing activities | (11,906) | 30,388 | (8,407) |
| Net (decrease) increase in cash | (10,344) | 34,614 | (8,838) |
| Cash and cash equivalents at beginning of year | 54,730 | 20,116 | 28,954 |
| Cash and cash equivalents at end of year | $ 44,386 | $ 54,730 | $ 20,116 |

## 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. 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 22 states with the ability to lend in 48 states.

| | As of or for the Year ended December 31, 2020 | | | |
|---|---|---|---|---|
| | Community Banking | Mortgage Banking | Holding Company and Other | Consolidated |
| | | (in thousands) | | |
| Net interest income (loss) | $ 54,616 | $ (1,171) | $ 55 | $ 53,500 |
| Provision for loan losses | 6,075 | 265 | - | 6,340 |
| Net interest income (loss) after provision for loan losses | 48,541 | (1,436) | 55 | 47,160 |
| Noninterest income | 8,723 | 236,659 | (1,365) | 244,017 |
| Noninterest expenses: | | | | |
| Compensation, payroll taxes, and other employee benefits | 20,233 | 119,432 | (619) | 139,046 |
| Occupancy, office furniture, and equipment | 3,688 | 6,535 | - | 10,223 |
| Advertising | 1,041 | 2,650 | - | 3,691 |
| Data processing | 2,284 | 1,636 | 21 | 3,941 |
| Communications | 411 | 918 | - | 1,329 |
| Professional fees | 695 | 7,376 | 47 | 8,118 |
| Real estate owned | (8) | - | - | (8) |
| Loan processing expense | - | 4,646 | - | 4,646 |
| Other | 2,507 | 10,345 | (777) | 12,075 |
| Total noninterest expenses | 30,851 | 153,538 | (1,328) | 183,061 |
| Income before income taxes | 26,413 | 81,685 | 18 | 108,116 |
| Income taxes | 5,219 | 21,744 | 8 | 26,971 |
| Net income | $ 21,194 | $ 59,941 | $ 10 | $ 81,145 |
| Total Assets | $ 2,116,560 | $ 456,076 | $ (388,049) | $ 2,184,587 |

| | As of or for the Year ended December 31, 2019 | | | |
|---|---|---|---|---|
| | Community Banking | Mortgage Banking | Holding Company and Other | Consolidated |
| | | (in thousands) | | |
| Net interest income | $ 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 | 55,069 | (2,060) | 88 | 53,097 |
| Noninterest income | 5,020 | 126,910 | (1,180) | 130,750 |
| Noninterest expenses: | | | | |
| 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 | 28,188 | 109,336 | (1,251) | 136,273 |
| Income before income taxes | 31,901 | 15,514 | 159 | 47,574 |
| Income taxes | 7,296 | 4,336 | 39 | 11,671 |
| Net income | $ 24,605 | $ 11,178 | $ 120 | $ 35,903 |
| Total Assets | $ 1,955,999 | $ 258,928 | $ (218,580) | $ 1,996,347 |

| | As of or for the Year ended December 31, 2018 | | | |
|---|---|---|---|---|
| | Community Banking | Mortgage Banking | Holding Company and Other | Consolidated |
| | (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 | 56,096 | (940) | 81 | 55,237 |
| 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 | 28,220 | 106,432 | (1,496) | 133,156 |
| Income before income taxes | 32,175 | 8,057 | 48 | 40,280 |
| Income taxes | 7,273 | 2,243 | 10 | 9,526 |
| Net income | $ 24,902 | $ 5,814 | $ 38 | $ 30,754 |
| Total Assets | $ 1,913,647 | $ 166,926 | $ (165,192) | $ 1,915,381 |

**20) 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, 2020.

At December 31, 2020, the Company had lease liabilities totaling $7.1 million and right-of-use assets totaling $6.6 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, 2020:

| | Year ended December 31, 2020 |
|---|---|
| | (In Thousands) |
| Operating lease cost | $ 3,158 |
| Variable cost | 487 |
| Short-term lease cost | 737 |
| Total | $ 4,382 |

At December 31, 2020, the Company had leases that had not yet commenced, but will create approximately $163,000 of additional lease liabilities and right-of-use assets for the Company in the first quarter of 2021.

The table below summarizes other information related to our operating leases:

| | Year ended December 31, 2020 (Dollars in Millions) |
|---|---|
| Cash paid for amounts included in the measurement of lease liabilities | |
| Operating cash flows from operating leases | $ 3.5 |
| Initial recognition of right-of-use asset | 1.0 |
| Initial recognition of lease liabilities | 1.0 |
| Weighted average remaining lease term - operating leases, in years | 3.51 |
| Weighted average discount rate - operating leases | 5.5% |

As of December 31, 2020, lease liability information for the Company is summarized in the following table.

| **Maturity analysis** | **Operating leases** (In Thousands) |
|---|---|
| One year or less | $ 2,726 |
| More than one year through two years | 1,970 |
| More than two years through three years | 1,527 |
| More than three years through four years | 939 |
| More than four years through five years | 531 |
| More than five years | 896 |
| Total lease payments | 8,589 |
| Present value discount | (1,457) |
| Lease Liability | $ 7,132 |

**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, 2020, 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, 2020 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, 2020. The report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2020, 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, 2020, 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, 2020, 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 1, 2021 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 1, 2021

**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 2021 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” and information concerning corporate governance under the caption “Other Board and Corporate Governance Matters” and "Board Meetings and Committees," 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.

| Name and Age | Offices and Positions with Waterstone Financial and Subsidiaries* | Executive Officer Since |
|---|---|---|
| Douglas S. Gordon, 63 | Chief Executive Officer and President of Waterstone Financial and of WaterStone Bank | 2005 |
| William F. Bruss, 51 | General Counsel, Executive Vice President and Secretary of Waterstone Financial and of WaterStone Bank | 2005 |
| Mark R. Gerke, 46 | Chief Financial Officer and Executive Vice President of Waterstone Financial and of WaterStone Bank | 2016 |
| Jeff McGuiness, 55 | Chief Executive Officer and President of Waterstone Mortgage Corporation | 2020 |
| Julie A. Glynn, 57 | 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 2021 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 2021 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, 2020 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.

| Plan | Number of shares to be issued upon exercise of outstanding options and rights | Weighted average option exercise price | Number of securities remaining available for issuance under plan |
|---|---|---|---|
| 2020 Omnibus Incentive Plan | 30,000 (1) | $ 16.61 | 1,220,000 |

(1) Consists of 30,000 shares reserved for grants of stock options. On December 31, 2020, 30,000 options were outstanding with a weighted average exercise price of $16.61 of which none 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 2021 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 2021 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, 2020 and 2019.

Consolidated Statements of Operations – Years ended December 31, 2020, 2019 and 2018.

Consolidated Statements of Comprehensive Income – Years ended December 31, 2020, 2019 and 2018.

Consolidated Statements of Changes in Shareholders' Equity – Years ended December 31, 2020, 2019 and 2018.

Consolidated Statements of Cash Flows – Years ended December 31, 2020, 2019 and 2018.

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**
**2020 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, 2020:

| Exhibit | Description | Filed Herewith |
|---|---|---|
| 3.1 | Articles of Incorporation of the Company (2) | |
| 3.2 | Bylaws of the Company (2) | |
| 4.1 | Common Stock Certificate (1) | |
| 4.2 | Description of Registant Securities (6) | |
| 10.1 | Waterstone Financial, Inc. 2020 Omnibus Incentive Plan †(8) | |
| 10.3 | Employment Agreement By and Between WaterStone Bank SSB and Douglas S. Gordon †(3) | |
| 10.4 | Change in Control Agreement Between WaterStone Bank SSB and Julie Glynn †(4) | |
| 10.6 | Waterstone Financial, Inc. Incentive Plan †(5) | |
| 10.7 | Employment Agreement By and Between Waterstone Mortgage Corporation and Jeff McGuiness †(9) | |
| 21.1 | List of Subsidiaries (7) | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm | X |
| 24.1 | Powers of Attorney | |
| 31.1 | Sarbanes-Oxley Act Section 302 Certification signed by the Chief Executive Officer of Waterstone Financial | X |
| 31.2 | Sarbanes-Oxley Act Section 302 Certification signed by the Chief Financial Officer of Waterstone Financial | X |
| 32.1 | 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 | X |
| 32.2 | 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 | X |
| XML | XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document | X |
| EX-101.SCH | Inline XBRL Taxonomy Extension Schema | X |
| EX-101.CAL | Inline XBRL Taxonomy Extension Calculation Linkbase | X |
| EX-101.DEF | Inline XBRL Taxonomy Extension Definition Linkbase | X |
| EX-101.LAB | Inline XBRL Taxonomy Label Linkbase | X |
| EX-101.PRE | Inline XBRL Taxonomy Extension Presentation Linkbase | X |
| EX-104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) | 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 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.

(3) 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).

(4) 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).

(5) 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).

(6) Incorporated by reference to Exhibit 4.2 to Report on Form 10-K filed with the U.S. Securities and Exchange Commission on March 13, 2020 (File No. 001-36271).

(7) Incorporated by reference to Exhibit 21.1 to Report on Form 10-K filed with the U.S. Securities and Exchange Commission on March 13, 2020 (File No. 001-36271).

(8) Incorporated by reference to Appendix A to the Definitive Proxy Statement for the 2020 Annual Meeting of Shareholders filed by Waterstone Financial, Inc. (Commission file no. 001-36271), filed with the U.S. Securities and Exchange Commission on April 9, 2020.

(9) Incorporated by reference to Exhibit 10.1 to Report on Form 8-K filed with the U.S. Securities and Exchange Commission on November 3, 2020 (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.

WATERSTONE FINANCIAL, INC.

March 01, 2021

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<br>Douglas S. Gordon,<br>*Chief Executive Officer and Director*<br>*(Principal Executive Officer)* | /s/ Patrick S. Lawton<br>Patrick S. Lawton, *Chairman and Director* |
| /s/ Mark R. Gerke<br>Mark R. Gerke<br>*Chief Financial Officer*<br>(*Principal Financial & Accounting Officer)* | /s/ Ellen S. Bartel<br>Ellen S. Bartel, *Director* |
| | /s/ Thomas E. Dalum<br>Thomas E Dalum, *Director* |
| | /s/ Michael L. Hansen<br>Michael L. Hansen, *Director* |
| | /s/ Kristine A. Rappé<br>Kristine A. Rappé, *Director* |
| | /s/ Stephen J. Schmidt<br>Stephen J. Schmidt, *Director* |
| | (1) Derek L. Tyus, *Director* |

*Each of the above signatures is affixed as of March 1, 2021.
(1) Mr. Tyus was elected to serve on the board of directors of Waterstone Financial, Inc. on February 8, 2021.

## 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**

**DEREK L. TYUS**

## 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

**JEFF MCGUINESS**
Chief Executive Officer & President

**KEVIN ALLEN**
Senior Vice President, Sales

**LISA FENSKE**
Senior Vice President, Marketing & Communications

**CHRIS FLEMMING**
Senior Vice President, National Sales

**TOM KNAPP**
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**
Chief Operating Officer

**STEPHANIE ZIEBELL**
Senior 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

**RYAN J. GORDON**
Senior Vice President
& Chief Credit Officer

**MICHAEL BACKAUS**
Vice President

**ANDREW T. BOARIO**
Vice President

**DENNIS CREEGAN**
Director of Mortgage
Banking Finance

**JAMES L. CROWLEY**
Vice President

**TODD M. CRUCIANI**
Vice President

**JULIE M. FAY-KRIVITZ**
Vice President

**MICHAEL S. GRIEBEL**
Vice President

**MARGARET HAAGENSEN**
Vice President

**JEFF JARECKI**
Vice President

**JACK D. KAHL**
Vice President

**SHAE MACLIN**
Vice President

**MEGAN A. MCCOY**
Vice President

**KYLE J. MERTZ**
Controller

**MARLENE D. MOLTER**
Vice President

**JOESEPH MUDLAFF**
Vice President

**THERESE M. PEKAR**
Vice President

**WENDY RICE**
Vice President
Retail Support

**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

**BILL KOTNAROWSKI**
Credit Officer

**ERIN MCCARTHY**
Assistant Vice President
Regional Manager

**DENISE L. MIHALJEVIC**
Legal Services Officer

**LAURA PINSON**
Assistant Vice President

**AL SCHEINPFLUG**
Facilities Officer

**JODI STEPHENS**
Benefits Officer

**LINDA ULRICH**
Sr. Loan Underwriting Lead

**CAROL CAREY**
Community President
Wauwatosa

**SHANDA CAVENEY**
Community President
Oak Creek/Howell Ave

**JENNIFER DE NICOLA**
Community President
Germantown/Menomonee Falls

**STACY EGGERSON**
Community President
Greenfield/Loomis Rd

**JENNIFER LITKOWIEC**
Community President
Oak Creek/27th St

**LAURA MERCHLE**
Community President
Brookfield

**DEMETRIUS NASH**
Community President
Milwaukee/Oklahoma Ave

**JENNIFER PERIC**
Community President
Franklin/Hales Corners

**CASSANDRA ROBEL**
Community President
Pewaukee

**MORGAN STRANDT**
Community President
Oconomowoc/Lake Country

**MEGAN WEIGAND**
Community President
Waukesha

**PAM ZORKO**
Community President
West Allis/Greenfield Ave

*As of March 2021*

CORPORATE HEADQUARTERS
11200 West Plank Court
Wauwatosa, WI 53226

*Serving Wisconsin Area Locations*

**Securities and advisory services are offered through LPL Financial (LPL), a registered investment advisor and broker/dealer (member FINRA/SIPC).** Insurance products are offered through LPL or its licensed affiliates. WaterStone Bank and WaterStone Investment Services **are not** registered as a broker/dealer or investment advisor. Registered representatives of LPL offer products and services using WaterStone Investment Services, and may also be employees of WaterStone Bank. These products and services are being offered through LPL or its affiliates, which are separate entities from and not affiliates of WaterStone Bank or WaterStone Investment Services. Securities and insurance offered through LPL or its affiliates are:

| Not Insured by FDIC or Any Other Government Agency | Not Bank Guaranteed | Not Bank Deposits or Obligations | May Lose Value |
| --- | --- | --- | --- |