Oconee Federal Financial Corp.
Form 10-Q
November 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period ended September 30, 2018

Or

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

For transition period from to

Commission File Number 001-35033

Oconee Federal Financial Corp.

(Exact Name of Registrant as Specified in Charter)

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

(864) 882-2765

Registrant's telephone number, including area code

Not Applicable

(Former name or former address, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T 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. (Check one):

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

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

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date.

There were 5,762,245 shares of Common Stock, par value $0.01 per share, outstanding as of November 5, 2018.

OCONEE FEDERAL FINANCIAL CORP.

Form 10-Q Quarterly Report

Table of Contents

OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share and per share data)

PART I

ITEM 1. FINANCIAL STATEMENTS

	September 30, 2018 (unaudited)	June 30, 2018
ASSETS		
Cash and due from banks	$ 3,538	$ 3,681
Interest-earning deposits	3,405	6,193
Fed funds sold	114	36
Total cash and cash equivalents	7,057	9,910
Securities available-for-sale	111,479	115,146
Loans	341,960	327,758
Allowance for loan losses	(1,151)	(1,097)
Net loans	340,809	326,661
Loans held for sale, at fair value	69	—
Premises and equipment, net	7,658	6,817
Real estate owned, net	775	1,074
Accrued interest receivable		
Loans	1,050	961
Investments	543	615
Restricted equity securities, at cost	1,745	1,639
Bank owned life insurance	18,668	18,554
Goodwill	2,593	2,593
Core deposit intangible	387	417
Loan servicing rights	1,050	1,093
Deferred tax assets	2,153	1,982
Other assets	444	497
Total assets	$ 496,480	$ 487,959
LIABILITIES		
Deposits		
Noninterest - bearing	$ 34,273	$ 31,189
Interest - bearing	360,147	356,399
Total deposits	394,420	387,588

FHLB advances	17,000	14,500
Accrued interest payable and other liabilities	783	1,006
Total liabilities	412,203	403,094
SHAREHOLDERS' EQUITY		
Common stock, $0.01 par value, 100,000,000 shares authorized;		
6,495,066 and 6,488,975 shares outstanding, respectively	65	65
Treasury stock, at par, 730,168 and 714,386 shares, respectively	(7)	(7)
Additional paid-in capital	11,582	12,000
Retained earnings	76,442	76,136
Accumulated other comprehensive loss	(3,053)	(2,528)
Unearned ESOP shares	(752)	(801)
Total shareholders' equity	84,277	84,865
Total liabilities and shareholders' equity	$ 496,480	$ 487,959

See accompanying notes to the consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(Amounts in thousands, except share and per share data)

	Three Months Ended September 30, 2018	September 30, 2017
Interest and dividend income:		
Loans, including fees	$ 3,767	$ 3,555
Securities, taxable	414	369
Securities, tax-exempt	209	206
Other interest-earning assets	31	35
Total interest income	4,421	4,165
Interest expense:		
Deposits	565	362
Other borrowings	85	11
Total interest expense	650	373
Net interest income	3,771	3,792
Provision for loan losses	72	46
Net interest income after provision for loan losses	3,699	3,746
Noninterest income:		
Service charges on deposit accounts	100	108
Income on bank owned life insurance	114	119
Mortgage servicing income	58	68
Gain on sale of mortgage loans	26	—
ATM & debit card income	73	68
Gain on sale of securities, net	1	10
Other	36	31
Total noninterest income	408	404
Noninterest expense:		
Salaries and employee benefits	1,686	1,556
Occupancy and equipment	415	397
Data processing	255	230
ATM & debit card expense	54	44
Professional and supervisory fees	196	206

Office expense	45	42
Advertising	50	45
FDIC deposit insurance	33	34
Foreclosed assets, net	13	50
Change in loan servicing asset	43	52
Other	207	211
Total noninterest expense	2,997	2,867
Income before income taxes	1,110	1,283
Income tax expense	226	426
Net income	$884	$ 857
Other comprehensive income/(loss)		
Unrealized ains/(losses) on securities available-for-sale	$(665)	$ 136
Tax effect	141	(50)
Reclassification adjustment for (gains)/losses realized in net income	(1)	(10)
Tax effect	—	4
Total other comprehensive income/(loss)	(525)	80
Comprehensive income	$359	$ 937
Basic net income per share: (Note 3)	$0.16	$ 0.15
Diluted net income per share: (Note 3)	$0.15	$ 0.15
Dividends declared per share:	$0.10	$ 0.10

See accompanying notes to the consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

(Amounts in thousands, except share and per share data)

	Common Stock	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Unearned ESOP Shares	Total
Balance at June 30, 2017	$ 65	$ (7)	$ 11,940	$ 75,169	$ (202)	$ (1,004)	$ 85,961
Net income	—	—	—	857	—	—	857
Other comprehensive income	—	—	—	—	80	—	80
Purchase of 7,576 shares of treasury stock[(1)]	—	—	(208)	—	—	—	(208)
Stock-based compensation expense	—	—	6	—	—	—	6
Dividends	—	—	—	(575)	—	—	(575)
ESOP shares earned	—	—	96	—	—	52	148
Balance at September 30, 2017	$ 65	$ (7)	$ 11,834	$ 75,451	$ (122)	$ (952)	$ 86,269
Balance at June 30, 2018	$ 65	$ (7)	$ 12,000	$ 76,136	$ (2,528)	$ (801)	$ 84,865
Net income	—	—	—	884	—	—	884
Other comprehensive loss	—	—	—	—	(525)	—	(525)
Purchase of 15,782 shares of treasury stock[(2)]	—	—	(521)	—	—	—	(521)
Stock-based compensation expense	—	—	36	—	—	—	36
Dividends	—	—	1	(578)	—	—	(577)
ESOP shares earned	—	—	66	—	—	49	115
Balance at September 30, 2018	$ 65	$ (7)	$ 11,582	$ 76,442	$ (3,053)	$ (752)	$ 84,277

(1) The weighted average cost of treasury shares purchased during the three months ended was $27.46 per share. Treasury stock repurchases were accounted for using the par value method.

(2) The weighted average cost of treasury shares purchased during the three months ended was $27.44 per share. Treasury stock repurchases were accounted for using the par value method.

See accompanying notes to the consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in thousands, except share and per share data)

	Three Months Ended	
	September 30, 2018	September 30, 2017
Cash Flows From Operating Activities		
Net income	$ 884	$ 857
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	72	46
Provision for real estate owned	18	26
Depreciation and amortization, net	298	345
Net (accretion)/amortization of purchase accounting adjustments	(56)	(39)
Deferred income tax expense/(benefit)	(30)	(19)
Net gain on sale of real estate owned	(12)	(4)
Net gain on sale of fixed assets	(29)	—
Change in loan servicing asset	43	52
Net gain on sales of securities	(1)	(10)
Mortgage loans originated for sale	(1,723)	(1,082)
Mortgage loans sold	1,680	1,337
Gain on sales of mortgage loans	(26)	(10)
Increase in cash surrender value of bank owned life insurance	(114)	(120)
ESOP compensation expense	115	148
Stock based compensation expense	36	6
Net change in operating assets and liabilities:		
Accrued interest receivable and other assets	36	192
Accrued interest payable and other liabilities	(223)	(102)
Net cash provided by operating activities	968	1,623
Cash Flows From Investing Activities		
Purchases of premises and equipment	(957)	(103)
Disposal of premises and equipment	29	—
Purchases of securities available-for-sale	(1,173)	(10,624)
Proceeds from maturities, paydowns and calls of securities available-for-sale	2,830	4,186
Proceeds from sales of securities available-for-sale	1,193	3,997
Purchases of restricted equity securities	(106)	(2)
Redemptions of restricted equity securities	—	(422)
Proceeds from sale of real estate owned	293	42
Loan originations and repayments, net	(14,164)	(5,410)
Net cash used in investing activities	(12,055)	(8,336)

Cash Flows from Financing Activities		
Net change in deposits	6,832	(16,827)
Proceeds from notes payable to FHLB	2,500	10,000
Dividends paid	(577)	(575)
Purchase of treasury stock	(521)	(208)
Net cash (used in)/provided by financing activities	8,234	(7,610)
Change in cash and cash equivalents	(2,853)	(14,323)
Cash and cash equivalents, beginning of period	9,910	20,745
Cash and cash equivalents, end of period	$7,057	$6,422

See accompanying notes to the consolidated financial statements

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

(1) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Oconee Federal Financial Corp., which include the accounts of its wholly owned subsidiary Oconee Federal Savings and Loan Association (the "Association") (referred to herein as "the Company," "we," "us," or "our"), have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Intercompany accounts and transactions are eliminated during consolidation. The Company is majority owned (72.24%) by Oconee Federal, MHC. These financial statements do not include the transactions and balances of Oconee Federal, MHC.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company's financial position as of September 30, 2018 and June 30, 2018 and the results of operations and cash flows for the interim periods ended September 30, 2018 and 2017. All interim amounts have not been audited, and the results of operations for the interim periods herein are not necessarily indicative of the results of operations to be expected for the year ending June 30, 2019 or any other period. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended June 30, 2018.

Certain amounts have been reclassified to conform to the current period presentation. The reclassifications had no effect on net income or shareholders' equity as previously reported.

Cash Flows: Cash and cash equivalents include cash on hand, federal funds sold, overnight interest-bearing deposits and amounts due from other depository institutions.

Use of Estimates: To prepare financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and actual results could differ.

(2) NEW ACCOUNTING STANDARDS

Accounting Standards Update ("ASU") 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement". Issued in August 2018, ASU 2018-13 provides guidance about fair value measurement disclosures. The amendment requires numerous removals, modifications and additions of fair value disclosure information. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years; early adoption is permitted. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this Update and delay adoption of the additional disclosures until their effective date. The Company does not expect these amendments to have a material effect on its consolidated financial statements.

ASU 2018-02, "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income". Issued in February 2018, ASU 2018-02 provides guidance with regard to the reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for certain stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years; early adoption is permitted. The Company adopted this standard effective March 31, 2018 and elected to reclassify the income tax effects of the Tax Cuts and Jobs Act from AOCI to retained earnings.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

ASU 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting”. Issued in May 2017, ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The amendments are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied prospectively to an award modified on or after the adoption date. The Company has determined that this guidance does not have a material effect on its consolidated financial statements.

ASU 2017-08, “Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities”. Issued in March 2017, ASU 2017-08 amends the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is assessing the impact of ASU 2017-08 on its consolidated financial statements.

ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment”. Issued in January 2017, ASU 2017-04 amendments eliminate Step 2 from the goodwill impairment test. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The guidance is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. ASU 2017-04 should be adopted on a prospective basis. The Company does not believe that this new guidance will have a material effect on its consolidated financial statements.

ASU 2016-15, “Statement of Cash Flows (Topic 230)”. Issued in August 2016, ASU 2016-15 provides guidance on the classification of certain cash receipts and cash payments for presentation in the statement of cash flows. The amendment is effective for the Company for fiscal years beginning after December 15, 2017, and interim periods within those years. The amendments will be applied using a retrospective transition method to each period presented unless impracticable. The Company has determined that this guidance does not have a material effect on its consolidated financial statements.

ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments". Issued in June 2016, ASU 2016-13 provides financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. ASU 2016-13 requires that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in ASU 2016-13 eliminate the probable incurred loss recognition in current GAAP and reflect an entity's current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets. For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination ("PCD assets") that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security. ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company has formed a management committee to address this issue, including consideration of third party vendor support. The Company is currently evaluating the impact of ASU 2016-13 on its consolidated financial statements.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities”. Issued in January 2016, ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The ASU affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. This ASU is now effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company has determined that this guidance does not have a material effect on its consolidated financial statements. However, the Company measured the fair value of its loan portfolio as of September 30, 2018 using an exit price notion.

ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)”. Issued in May 2014, ASU 2014-09 provides a framework for revenue recognition that replaces the existing industry and transaction specific requirements under the existing standards. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the Financial Accounting Standards Board (“FASB”) approved amendments deferring the effective date by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In March and April 2016, the FASB issued final amendments (ASU 2016-08 and ASU 2016-10) to clarify the implementation guidance for principal versus agent considerations, identifying performance obligations and the accounting for licenses of intellectual property. In May 2016, the FASB issued final amendments (ASU-11) to clarify guidance related to collectability, noncash considerations, presentation of sales tax, and transition. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. The Company adopted the new guidance effective July 1, 2018 and intends to utilize the modified retrospective method. Under the modified retrospective method the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the Company does not expect the new guidance to have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The Company has completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including deposit related fees, interchange fees, and merchant income. Based on this assessment, the Company concluded that ASU 2014-09 does not materially change the method in which the Company currently recognizes revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on its evaluation, the Company determined that the classification of certain debit and credit card related revenues should change (i.e., revenue previously recorded as contra-expense will be recorded as revenue). These classification changes are expected to result in an immaterial net increase of both revenue and expense. This change is not expected to have a material effect to noninterest income or expense. The Company adopted ASU 2014-09 on its required effective date of July 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. The Company did reclassify prior period amounts for the debit and credit card costs noted above.

There have been no accounting standards that have been issued or proposed by the FASB or other standards-setting bodies during this quarter that are expected to have a material impact on the Company’s financial position, results of operations or cash flows. The Company continues to evaluate the impact of standards previously issued and not yet effective, and have no changes in our assessment to disclose since filing of the Form 10-K.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

(3) EARNINGS PER SHARE ("EPS")

Basic EPS is based on the weighted average number of common shares outstanding and is adjusted for ESOP shares not yet committed to be released. Unvested restricted stock awards, which contain rights to non-forfeitable dividends, are considered participating securities and the two-class method of computing basic and diluted EPS is applied. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as outstanding stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Diluted EPS is calculated by adjusting the weighted average number of shares of common stock outstanding to include the effect of contracts or securities exercisable (such as stock options) or which could be converted into common stock, if dilutive, using the treasury stock method. The factors used in the earnings per common share computation follow:

	Three Months Ended September 30, 2018	September 30, 2017
Earnings per share		
Net income	$884	$857
Less: distributed earnings allocated to participating securities	(2)	(2)
Less: (undistributed income) dividends in excess of earnings allocated to participating securities	—	(1)
Net earnings available to common shareholders	$882	$854
Weighted average common shares outstanding including participating securities	5,774,160	5,786,109
Less: participating securities	(15,355)	(21,910)
Less: average unearned ESOP shares	(74,939)	(83,090)
Weighted average common shares outstanding	5,683,866	5,681,109
Basic earnings per share	$0.16	$0.15
Weighted average common shares outstanding	5,683,866	5,681,109
Add: dilutive effects of assumed exercises of stock options	127,375	119,447
Average shares and dilutive potential common shares	5,811,241	5,800,556
Diluted earnings per share	$0.15	$0.15

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

During the three months ended September 30, 2018, 22,400 shares were considered anti-dilutive as the exercise price was in excess of the average market price for the respective periods. During the three months ended September 30, 2017 no shares were considered anti-dilutive.

(4) SECURITIES AVAILABLE-FOR-SALE

Debt, mortgage-backed and equity securities have been classified in the consolidated balance sheets according to management's intent. U.S. Government agency mortgage-backed securities consist of securities issued by U.S. Government agencies and U.S. Government sponsored enterprises. Investment securities at September 30, 2018 and June 30, 2018 are as follows:

September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
FHLMC common stock	$ 20	$ 94	$ —	$ 114
Certificates of deposit	5,735	—	(88)	5,647
Municipal securities	42,080	1	(1,366)	40,715
SBA loan pools	375	2	—	377
CMOs	9,828	—	(493)	9,335
U.S. Government agency mortgage-backed securities	43,284	—	(1,412)	41,872
U.S. Government agency bonds	14,022	—	(603)	13,419
Total available-for-sale	$ 115,344	$ 97	$ (3,962)	$ 111,479

June 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
FHLMC common stock	$ 20	$ 109	$ —	$ 129
Certificates of deposit	5,485	—	(94)	5,391
Municipal securities	43,393	14	(1,069)	42,338
SBA loan pools	401	2	—	403
CMOs	10,529	—	(445)	10,084

U.S. Government agency mortgage-backed securities	44,490	6	(1,206)	43,290
U.S. Government agency bonds	14,027	—	(516)	13,511
Total available-for-sale	$ 118,345	$ 131	$ (3,330)	$ 115,146

Securities pledged at September 30, 2018 and June 30, 2018 had fair values of $40,217 and $42,098, respectively. These securities were pledged to secure public deposits and FHLB advances.

At September 30, 2018 and June 30, 2018, there were no holdings of securities of any one issuer, other than U.S. Government agencies and U.S. Government sponsored enterprises, in an amount greater than 10% of shareholders' equity.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

The following tables show the fair value and unrealized loss of securities that have been in unrealized loss positions for less than twelve months and for twelve months or more at September 30, 2018 and June 30, 2018. The tables also show the number of securities in an unrealized loss position for each category of investment security as of the respective dates.

	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Loss	Number in Unrealized Loss[1]	Fair Value	Unrealized Loss	Number in Unrealized Loss[1]	Fair Value	Unrealized Loss	Number in Unrealized Loss[1]
September 30, 2018									
Available-for-sale:									
Certificates of deposit	$5,398	$ (88)	22	$—	$ —	—	$5,398	$ (88)	22
Municipal securities	20,953	(411)	58	19,307	(955)	46	40,260	(1,366)	104
CMOs	—	—	—	9,335	(493)	16	9,335	(493)	16
U.S. Government agency mortgage-backed securities	13,761	(308)	22	28,111	(1,104)	37	41,872	(1,412)	59
U.S. Government agency bonds	3,326	(123)	4	10,093	(480)	10	13,419	(603)	14
	$43,438	$ (930)	106	$66,846	$ (3,032)	109	$110,284	$ (3,962)	215

	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Loss	Number in Unrealized Loss[1]	Fair Value	Unrealized Loss	Number in Unrealized Loss[1]	Fair Value	Unrealized Loss	Number in Unrealized Loss[1]
June 30, 2018									
Available-for-sale:									
Certificates of deposit	$5,391	$ (94)	22	$—	$ —	—	$5,391	$ (94)	22
Municipal securities	28,305	(587)	75	10,789	(482)	25	39,094	(1,069)	100
CMOs	1,334	(38)	2	8,750	(407)	14	10,084	(445)	16
U.S. Government agency mortgage-backed securities	30,997	(773)	43	10,887	(433)	13	41,884	(1,206)	56
	5,789	(177)	7	7,722	(339)	7	13,511	(516)	14

U.S. Government agency bonds	$71,816	$(1,669)	149	$38,148	$(1,661)	59	$109,964	$(3,330)	208

(1) Actual amounts.

The Company evaluates securities for other-than-temporary impairments ("OTTI") at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company considers the length of time and the extent to which the fair value has been less than amortized cost and the financial condition and near-term prospects of the issuer. Additionally, the Company considers its intent to sell or whether it will be more likely than not it will be required to sell the security prior to the security's anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by federal Government agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

None of the unrealized losses at September 30, 2018 were recognized into net income for the three months ended September 30, 2018 because the issuers' bonds are of high credit quality, management does not intend to sell and it is more likely than not that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value of these securities is expected to recover as they approach their maturity date or reset date. None of the unrealized losses at June 30, 2018 were recognized as having OTTI during the year ended June 30, 2018.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

The following table presents the amortized cost and fair value of debt securities classified as available-for-sale at September 30, 2018 and June 30, 2018 by contractual maturity.

	September 30, 2018		June 30, 2018	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less than one year	$2,503	$2,488	$1,004	$1,003
Due from one to five years	20,880	20,392	19,415	19,049
Due after five years to ten years	29,142	28,037	33,186	32,230
Due after ten years	9,687	9,241	9,701	9,361
Mortgage-backed securities, CMOs and FHLMC stock (1)	53,132	51,321	55,039	53,503
Total available for sale	$115,344	$111,479	$118,345	$115,146

(1) Actual cash flows may differ from contractual maturities as borrowers may prepay obligations without prepayment penalty. FHLMC common stock is not scheduled because it has no contractual maturity date.

The following table presents the gross proceeds from sales of securities available-for-sale and gains or losses recognized for the three months ended September 30, 2018 and 2017:

Available-for-sale:	Three Months Ended September 30, 2018	September 30, 2017
Proceeds	$1,193	$ 3,997
Gross gains	3	11
Gross losses	(2)	(1)

The tax provision related to these net realized gains for the three months ended September 30, 2018 was less than $1, and for the three months ended September 30, 2017 was $3.

(5) LOANS

The components of loans at September 30, 2018 and June 30, 2018 were as follows:

	September 30, 2018	June 30, 2018
Real estate loans:		
One-to-four family	$275,577	$269,868
Multi-family	1,712	1,735
Home equity	4,303	3,914
Nonresidential	17,807	17,591
Agricultural	1,215	1,272
Construction and land	35,311	27,513
Total real estate loans	335,925	321,893
Commercial and industrial	302	326
Consumer and other loans	5,733	5,539
Total loans	$341,960	$327,758

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

The following table presents the activity in the allowance for loan losses for the three months ended September 30, 2018 by portfolio segment:

Three Months Ended September 30, 2018	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
One-to-four family	$939	$35	$(18)	$—	$956
Multi-family	4	—	—	—	4
Home equity	8	5	—	—	13
Nonresidential	66	3	—	—	69
Agricultural	1	—	—	—	1
Construction and land	74	24	—	—	98
Total real estate loans	1,092	67	(18)	—	1,141
Commercial and industrial	4	(1)	—	—	3
Consumer and other loans	1	6	—	—	7
Total loans	$1,097	$72	$(18)	$—	$1,151

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at September 30, 2018:

At September 30, 2018	Ending Allowance on Loans: Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Loans: Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Real estate loans:				
One-to-four family	$—	$ 956	$2,403	$ 273,174
Multi-family	—	4	—	1,712
Home equity	—	13	—	4,303
Nonresidential	—	69	656	17,151
Agricultural	—	1	413	802
Construction and land	—	98	—	35,311

Total real estate loans	—	1,141	3,472	332,453
Commercial and industrial	—	3	—	302
Consumer and other loans	—	7	—	5,733
Total loans	$ —	$ 1,151	$ 3,472	$ 338,488

13

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

The following table presents the activity in the allowance for loan losses for the three months ended September 30, 2017 by portfolio segment:

Three Months ended September 30, 2017	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
One-to-four family	$900	$(11)	$—	$—	$889
Multi-family	4	—	—	—	4
Home equity	2	14	(13)	—	3
Nonresidential	63	(3)	—	—	60
Agricultural	1	—	—	—	1
Construction and land	35	45	(25)	—	55
Total real estate loans	1,005	45	(38)	—	1,012
Commercial and industrial	4	2	—	—	6
Consumer and other loans	7	(1)	—	—	6
Total loans	$1,016	$46	$(38)	$—	$1,024

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at June 30, 2018:

At June 30, 2018	Ending Allowance on Loans: Individually Evaluated for Impairment	Ending Allowance on Loans: Collectively Evaluated for Impairment	Loans: Individually Evaluated for Impairment	Loans: Collectively Evaluated for Impairment
Real estate loans:				
One-to-four family	$—	$ 939	$2,434	$ 267,434
Multi-family	—	4	—	1,735
Home equity	—	8	—	3,914
Nonresidential	—	66	671	16,920
Agricultural	—	1	424	848
Construction and land	—	74	—	27,513

Total real estate loans	—	1,092	3,529	318,364
Commercial and industrial	—	4	—	326
Consumer and other loans	—	1	—	5,539
Total loans	$ —	$ 1,097	$ 3,529	$ 324,229

14

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

The tables below present loans that were individually evaluated for impairment by portfolio segment at September 30, 2018 and June 30, 2018, including the average recorded investment balance and interest earned for the three months ended September 30, 2018 and the year ended June 30, 2018:

	September 30, 2018				
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no recorded allowance:					
Real estate loans:					
One-to-four family	$2,481	$ 2,403	$ —	$ 2,419	$ 15
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	692	656	—	664	—
Agricultural	962	413	—	419	—
Construction and land	—	—	—	—	—
Total real estate loans	4,135	3,472	—	3,502	15
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total	$4,135	$ 3,472	$ —	$ 3,502	$ 15

With recorded allowance:					
Real estate loans:					
One-to-four family	$—	$—	$—	$—	$—
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	—	—	—	—	—
Agricultural	—	—	—	—	—
Construction and land	—	—	—	—	—
Total real estate loans	—	—	—	—	—
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total	$—	$—	$—	$—	$—

Totals:					
Real estate loans	$4,135	$3,472	$—	$3,502	$15
Consumer and other loans	—	—	—	—	—
Total	$4,135	$3,472	$—	$3,502	$15

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

	June 30, 2018				
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no recorded allowance:					
Real estate loans:					
One-to-four family	$2,516	$ 2,434	$ —	$ 2,251	$ 67
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	707	671	—	336	3
Agricultural	972	424	—	436	7
Construction and land	—	—	—	131	—
Total real estate loans	4,195	3,529	—	3,154	77
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total	$4,195	$ 3,529	$ —	$ 3,154	$ 77
With recorded allowance:					
Real estate loans:					
One-to-four family	$—	$—	$—	$484	$—
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	—	—	—	—	—
Agricultural	—	—	—	—	—
Construction and land	—	—	—	—	—
Total real estate loans	—	—	—	484	—
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total	$—	$—	$—	$484	$—
Totals:					
Real estate loans	$4,195	$3,529	$—	$3,638	$77
Consumer and other loans	—	—	—	—	—
Total	$4,195	$3,529	$—	$3,638	$77

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

The following tables present the aging of past due loans as well as nonaccrual loans. Nonaccrual loans and accruing loans past due 90 days or more include both smaller balance homogenous loans and larger balance loans that are evaluated either collectively or individually for impairment.

Total past due loans and nonaccrual loans at September 30, 2018:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	$6,772	$1,806	$865	$9,443	$266,134	$275,577	$ 3,682	$ —
Multi-family	—	—	—	—	1,712	1,712	—	—
Home equity	84	39	40	163	4,140	4,303	40	—
Nonresidential	384	154	—	538	17,269	17,807	884	—
Agricultural	—	413	—	413	802	1,215	413	—
Construction and land	175	49	—	224	35,087	35,311	11	—
Total real estate loans	7,415	2,461	905	10,781	325,144	335,925	5,030	—
Commercial and industrial	—	—	—	—	302	302	—	—
Consumer and other loans	—	—	4	4	5,729	5,733	4	—
Total	$7,415	$2,461	$909	$10,785	$331,175	$341,960	$ 5,034	$ —

Total past due and nonaccrual loans by portfolio segment at June 30, 2018:

	30-59 Days	60-89 Days	90 Days	Total		Total	Nonaccrual	Accruing Loans Past Due 90

	Past Due	Past Due	or More Past Due	Past Due	Current	Loans	Loans	Days or More
Real estate loans:								
One-to-four family	$5,180	$1,787	$ 897	$7,864	$262,004	$269,868	$ 3,969	$ —
Multi-family	—	—	—	—	1,735	1,735	—	—
Home equity	106	84	40	230	3,684	3,914	40	—
Nonresidential	376	179	—	555	17,036	17,591	908	—
Agricultural	—	424	—	424	848	1,272	445	—
Construction and land	50	34	—	84	27,429	27,513	19	—
Total real estate loans	5,712	2,508	937	9,157	312,736	321,893	5,381	—
Commercial and industrial	—	—	—	—	326	326	—	—
Consumer and other loans	—	—	—	—	5,539	5,539	1	—
Total	$5,712	$2,508	$ 937	$9,157	$318,601	$327,758	$ 5,382	$ —

17

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

Troubled Debt Restructurings:

At September 30, 2018 and June 30, 2018, total loans that have been modified as troubled debt restructurings were $3,082 and $3,016, respectively, which consisted of one construction loan, two agricultural loans, two nonresidential real estate and five one-to-four family first lien loans at September 30, 2018 and one construction loan, two agricultural loans, two non-residential real estate loans and four one-to-four family first lien loans at June 30, 2018. There was no specific allowance for loss established for these loans at September 30, 2018 or June 30, 2018. Additionally, there were no commitments to lend any additional amounts on any loan after the modification. The one-to-four family first lien troubled debt restructured during the three months ended September 30, 2018 involved renewing an existing loan with a term concession. No loans modified as troubled debt restructurings during the twelve months ended September 30, 2018 have defaulted since restructuring. All of these loans are on non-accrual at September 30, 2018 and June 30, 2018. At September 30, 2018 and June 30, 2018, $2,470 and $2,521, respectively, were individually evaluated for impairment.

Loan Grades:

The Company utilizes a grading system whereby all loans are assigned a grade based on the risk profile of each loan. Loan grades are determined based on an evaluation of relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. All loans, regardless of size, are analyzed and are given a grade based upon the management’s assessment of the ability of borrowers to service their debts.

Pass: Loan assets of this grade conform to a preponderance of our underwriting criteria and are acceptable as a credit risk, based upon the current net worth and paying capacity of the obligor. Loans in this category also include loans secured by liquid assets and secured loans to borrowers with unblemished credit histories.

Pass-Watch: Loan assets of this grade represent our minimum level of acceptable credit risk. This grade may also represent obligations previously rated “Pass”, but with significantly deteriorating trends or previously rated.

Special Mention: Loan assets of this grade have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of repayment prospects for the loan or of the institution's credit position at some future date.

Substandard: Loan assets of this grade are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

Portfolio Segments:

One-to-four family: One-to-four family residential loans consist primarily of loans secured by first or second deeds of trust on primary residences, and are originated as adjustable-rate or fixed-rate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. The Company currently originates residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes.

For traditional homes, the Company may originate loans with loan-to-value ratios in excess of 80% if the borrower obtains mortgage insurance or provides readily marketable collateral. The Company may make exceptions for special loan programs that we offer. The Company also originates residential mortgage loans for non-owner-occupied homes with loan-to-value ratios of up to 80%.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

The Company historically originated residential mortgage loans with loan-to-value ratios of up to 75% for manufactured or modular homes. The Company no longer offers residential mortgage loans for manufactured or modular homes as of December 1, 2014. However, renewals of existing performing credits that meet the Company's underwriting requirements will be considered. The Company requires lower loan-to-value ratios for manufactured and modular homes because such homes tend to depreciate over time. Manufactured or modular homes must be permanently affixed to a lot to make them more difficult to move without the Company's permission. Such homes must be "de-titled" by the State of South Carolina or Georgia so that they are taxed and must be transferred as residential homes rather than vehicles. The Company also obtains a mortgage on the real estate to which such homes are affixed.

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

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

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

Nonresidential Real Estate: Nonresidential loans include those secured by real estate mortgages on churches, owner-occupied and non-owner-occupied commercial buildings of various types, retail and office buildings, hotels, and other business and industrial properties. The nonresidential real estate loans that the Company originates generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of our nonresidential real estate loans is generally 75%.

Loans secured by nonresidential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Nonresidential real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. Our nonresidential real estate lending includes a significant amount of loans to churches. Because a church's financial stability often depends on donations from congregation members rather than income from business operations, repayment may be affected by economic conditions that affect individuals located both in our market area and in other market areas with which we are not as familiar. In addition, due to the unique nature of church buildings and properties, the real estate securing church loans may be less marketable than other nonresidential real estate.

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

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

Agricultural: These loans are secured by farmland and related improvements in the Company's market area. These loans generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of these loans is generally 75%. The Company is managing a small number of these loans in our portfolio. We continue to closely monitor our existing relationships.

Loans secured by agricultural real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Agricultural real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions.

Construction and Land: The Company makes construction loans to individuals for the construction of their primary residences and to commercial businesses for their real estate needs. These loans generally have maximum terms of twelve months, and upon completion of construction convert to conventional amortizing mortgage loans. Residential construction loans have rates and terms comparable to one-to-four family residential mortgage loans that the Company originates. Commercial construction loans have rate and terms comparable to commercial loans that we originate. During the construction phase, the borrower generally pays interest only. Generally, the maximum loan-to-value ratio of our owner-occupied construction loans is 80%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential mortgage loans. Commercial construction loans are generally underwritten pursuant to the same guidelines used for originating commercial loans.

The Company also makes interim construction loans for nonresidential properties. In addition, the Company occasionally makes loans for the construction of homes "on speculation," but the Company generally permits a borrower to have only two such loans at a time. These loans generally have a maximum term of eight months, and upon completion of construction convert to conventional amortizing nonresidential real estate loans. These construction loans have rates and terms comparable to permanent loans secured by property of the type being constructed that we originate. Generally, the maximum loan-to-value ratio of these construction loans is 85%.

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

Commercial and industrial loans and leases typically are underwritten on the basis of the borrower's or lessee's ability to make repayment from the cash flow of its business and generally are collateralized by business assets. As a result, such loans and leases involve additional complexities, variables and risks and require more thorough underwriting and servicing than other types of loans and leases.

Consumer and Other Loans: The Company offers installment loans for various consumer purposes, including the purchase of automobiles, boats, and for other legitimate personal purposes. The maximum terms of consumer loans is 18 months for unsecured loans and 18 to 60 months for loans secured by a vehicle, depending on the age of the vehicle. The Company generally only extends consumer loans to existing customers or their immediate family members, and these loans generally have relatively low balances.

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except share and per share data)

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

Based on the most recent analysis performed, the risk grade of loans by portfolio segment are presented in the following tables.

Total loans by risk grade and portfolio segment at September 30, 2018:

	Pass	Pass-Watch	Special Mention	Substandard	Doubtful	Total
Real estate loans:						
One-to-four family	$260,581	$ 5,171	$ 3,164	$ 6,661	$ —	$275,577
Multi-family	1,712	—	—	—	—	1,712
Home equity	3,658	344	127	174	—	4,303
Nonresidential	13,759	1,771	1,128	1,149	—	17,807
Agricultural	201	343	258	413	—	1,215
Construction and land	34,368	761	113	69	—	35,311
Total real estate loans	314,279	8,390	4,790	8,466	—	335,925
Commercial and industrial	302	—	—	—	—	302
Consumer and other loans	5,729	—	—	4	—	5,733
Total	$320,310	$ 8,390	$ 4,790	$ 8,470	$ —	$341,960

Total loans by risk grade and portfolio segment at June 30, 2018:

	Pass	Pass-Watch	Special Mention	Substandard	Doubtful	Total

Real estate loans:						
One-to-four family	$254,721	$ 5,051	$ 3,350	$ 6,746	$ —	$269,868
Multi-family	1,735	—	—	—	—	1,735
Home equity	3,298	311	129	176	—	3,914
Nonresidential	13,462	1,802	1,143	1,184	—	17,591
Agricultural	217	349	261	445	—	1,272
Construction and land	26,551	771	115	76	—	27,513
Total real estate loans	299,984	8,284	4,998	8,627	—	321,893
Commercial and industrial	326	—	—	—	—	326
Consumer and other loans	5,539	—	—	—	—	5,539
Total	$305,849	$ 8,284	$ 4,998	$ 8,627	$ —	$327,758

At September 30, 2018, consumer mortgage loans secured by residential real estate properties totaling $524 were in formal foreclosure proceedings a