Waterstone Financial, Inc.
Form 10-K
March 21, 2014
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

F O R M 1 0 - 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, 2013

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:

Common Stock, $0.01 Par Value	The NASDAQ Stock Market, LLC
(Title of class)	(Name of each exchange on which registered)

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 o No þ

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 o No þ

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)

Yes þ No o

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

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer (Do not check if a smaller reporting company) o	Smaller Reporting Company o

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

Yes o No þ

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 January 23, 2014 (the first day of trading in the Registrant's common stock) as reported by the NASDAQ Global Select Market® was approximately $366.8 million.

As of February 28, 2014, 34,389,312 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 20, 2014	Part III

WATERSTONE FINANCIAL, INC.

FORM 10-K ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION
FOR THE YEAR ENDED DECEMBER 31, 2013

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PART 1

Item 1. Business

Forward-Looking Statements

This Form 10-K contains or incorporates 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, are intended to identify forward-looking statements. 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, that are worse than expected;
- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins and yields, our mortgage banking revenues or reduce the fair value of financial instruments or reduce the origination levels in our lending business, or increase the level of defaults, losses or prepayments on loans we have made and make whether held in portfolio or sold in the secondary markets;
- adverse changes in the securities or secondary mortgage markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- 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;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;
- our ability to retain key employees;
- 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 June 2013. Upon completion of the mutual-to-stock conversion of Lamplighter Financial, MHC in January 2014, New Waterstone became the holding company of WaterStone Bank SSB ("WaterStone Bank") 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, 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, SSB, 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, Inc.'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 89 offices in 22 states as of December 31, 2013.
WaterStone Bank conducts its community banking business from nine banking offices located in Milwaukee, Washington and Waukesha Counties, Wisconsin, as well as a loan production office in Maple Grove, Minnesota. WaterStone Bank's principal lending activity is originating one- to four-family and multi-family residential real estate loans for retention in its portfolio.   At December 31, 2013, such loans comprised 37.9% and 47.8%, respectively, of WaterStone Bank's loan portfolio. WaterStone Bank also offers, to a lesser extent, home equity loans and lines of credit, construction and land loans, commercial real estate and 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, non-interest bearing demand accounts and individual retirement accounts. Our investment securities portfolio is comprised principally of mortgage-backed securities, government-sponsored enterprise bonds and municipal obligations.
WaterStone Bank is subject to comprehensive regulation and examination by the WDFI and the Federal Deposit Insurance Corporation.

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 to be a part of this prospectus.

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 lines of credit with other financial institutions as needed. During both years ended December 31, 2013 and 2012, Waterstone Mortgage Corporation originated approximately $1.75 billion in mortgage loans held for sale.

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 four branch offices in Milwaukee County, four branch offices in Waukesha County and one branch office in Washington County. At June 30, 2013 (the latest date for which information was publicly available), 47.8% of deposits in the State of Wisconsin were located in the seven-county metropolitan Milwaukee market and 41.8% 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. In addition, in October 2013 we opened a loan production office in Maple Grove, Minnesota, which is expected to have a primary lending market area of the Minneapolis-St. Paul, Minnesota metropolitan market.

From 2000 to 2010, our market area experienced population increases from a high of 13.1% in Jefferson County to a low of 0.8% in Milwaukee County, compared to 6.0% for Wisconsin and 9.7% for the United States as a whole. Projections indicate that through 2017, the population will continue to increase in all market area counties ranging from a low of 1.0% in Racine County to a high of 4.6% in Washington County compared to projected increases of 3.2% and 4.9% in Wisconsin and the United States, respectively. Consistent with trends in population, our market areas experienced increases in households from 2000 to 2010 at rates ranging from a high of 17.7% in Washington County to a low of 1.6% in Milwaukee County, compared to increases in households of 9.4% in Wisconsin and 10.7% in the United States. Through 2017, households are projected to increase at rates ranging from 1.6% in Racine County to 4.7% in Washington County, compared to 3.6% in Wisconsin and 5.1% in the United States.

The 2000 median household income levels of six of our seven community banking market area counties were above the state and national levels, with Milwaukee County being the only county with per capita income levels below state and national levels. The 2000 median household income levels ranged from a low of $38,100 in Milwaukee County to a high of $62,839 in Waukesha County. From 2000 to 2010, median household income increased in all area counties by percentages ranging from a low of 6.8% in Milwaukee County to a high of 19.4% in Walworth County. In 2010, median household income ranged from a low of $40,702 in Milwaukee County to a high of $73,703 in Ozaukee County, with all but Milwaukee County having higher median income levels than both the state and national levels of $50,395 and $50,046, respectively. By 2017, the projected increases in median household income are expected to range from 3.0% in Walworth County to 22.8% in Milwaukee County, with median household income levels in Jefferson, Milwaukee and Walworth Counties increasing less than both state and national levels and the four other counties increasing more that the increases at the state and national levels. The 2017 projected median household income levels ranged from $50,001 in Milwaukee County to $81,501 in Waukesha County, compared to $57,220 in Wisconsin and $56,895 in the United States.

In 2008, four of the seven counties in the market area had lower unemployment rates than that of the State of Wisconsin as a whole while the remaining three counties had unemployment rates lower than that of the United States as a whole. Through 2010, unemployment rates increased in the United States and in Milwaukee County but decreased in Wisconsin as a whole and in six of the market area counties. In 2011 and 2012, unemployment rates continued to decrease in all market areas. In 2013, unemployment rates decreased in all market area counties, with the exception of Racine County and ranged from a high of 8.6% in Racine County to a low of 5.4% in Ozaukee County compared to 6.8% in Wisconsin and 7.4% in the United States.

According to the 2010 Census, the median home values in the community banking market area ranged from a low of $159,800 in Milwaukee County to a high of $253,700 in Ozaukee County, with an average of $204,414 for the seven market area counties. Median 2010 home values for the State of Wisconsin and for the United States were $166,700 and $179,900, respectively.

In March 2013, Corelogic reported that the foreclosure rate in the metropolitan Milwaukee area, Milwaukee, Waukesha, Ozaukee and Washington Counties, fell to 1.97% of mortgaged homes in January 2013 from 2.69% in January 2012. Similarly, the foreclosure rate for the State of Wisconsin fell to 1.68% in January 2013 from 2.30% in January 2012. For the United States, the foreclosure rate dropped to 2.8% in 2013 compared to 3.5% in 2012. In a related trend, year-over-year increases in home sales in market area counties are reported. According to Metro MLS Inc. data released by the Greater Milwaukee Association of Realtors, home sales in December 2013 increased by 5.0% compared to December 2012 for the metropolitan area defined as Milwaukee, Waukesha, Ozaukee, and Washington counties.

Waterstone Mortgage Corporation. As of December 31, 2013, Waterstone Mortgage Corporation had 21 offices in Wisconsin, 11 offices in Florida, 10 offices in Pennsylvania, 8 offices in Minnesota, six offices in each of North Carolina and Virginia, four offices in Indiana, three offices in each of Arizona, Ohio and Tennessee, two offices in each of Illinois and Iowa and one office in each of Arkansas, Colorado, Idaho, Massachusetts, Maryland, Maine, New Hampshire, Oklahoma, Oregon and Washington.

Competition

WaterStone Bank. WaterStone Bank faces competition within our market area both in making real estate loans and attracting deposits. The Milwaukee-Waukesha-West Allis metropolitan statistical area has a high concentration of financial institutions, including large commercial banks, community banks and credit unions. The Federal Deposit Insurance Corporation has determined that our market area is a "high-rate" area with regard to deposit pricing as compared to the rest of the United States. As of June 30, 2013, based on the Federal Deposit Insurance Corporation's annual Summary of Deposits Report, we had the eighth largest market share in our metropolitan statistical area out of 56 financial institutions in our metropolitan statistical area, representing 1.6% 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, private banking and brokerage and insurance services.
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. In 2013, the Business Journal of Milwaukee ranked Waterstone Mortgage Corporation as southeastern Wisconsin's largest mortgage lender for the fifth year in a row.

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 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 $413.6 million, or 37.9%, of our total loan portfolio at December 31, 2013. Multi-family residential mortgage loans represented $521.6 million, or 47.8%, of our total loan portfolio at December 31, 2013. We also offer construction and land loans, commercial real estate loans, home equity lines of credit and commercial loans. At December 31, 2013, commercial real estate loans, construction and land loans, home equity loans and commercial business loans totaled $71.7 million, $31.9 million, $35.4 million and $18.3 million, respectively.

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,									
	2013		2012		2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Mortgage loans:										
Residential real estate:										
One- to four-family	$413,614	37.85 %	$460,821	40.65 %	$496,736	40.83 %	$582,026	44.56 %	$679,657	47.86 %
Multi-family	521,597	47.75 %	514,363	45.37 %	552,240	45.39 %	542,602	41.53 %	536,731	37.80 %
Home equity	35,432	3.24 %	36,494	3.22 %	38,599	3.17 %	46,149	3.53 %	57,589	4.06 %
Construction and land	31,905	2.92 %	33,818	2.98 %	39,528	3.25 %	53,961	4.13 %	61,953	4.36 %
Commercial real estate	71,698	6.56 %	65,495	5.78 %	65,434	5.38 %	51,733	3.96 %	48,948	3.45 %
Commercial loans	18,296	1.67 %	22,549	1.99 %	24,018	1.97 %	29,812	2.28 %	34,513	2.43 %
Consumer	134	0.01 %	132	0.01 %	109	0.01 %	154	0.01 %	619	0.04 %
Total loans	1,092,676	100.00 %	1,133,672	100.00 %	1,216,664	100.00 %	1,306,437	100.00 %	1,420,010	100.00 %
Allowance for loan losses	(24,264)		(31,043)		(32,430)		(29,175)		(28,494)	
Loans, net	$1,068,412		$1,102,629		$1,184,234		$1,277,262		$1,391,516	

Loan Portfolio Maturities and Yields. The following table summarizes the final maturities of our loan portfolio at December 31, 2013. Maturities are based upon the final contractual payment dates and do not reflect the impact of prepayments and scheduled monthly payments that will occur.

Due during the year ended December 31,	One- to four-family Amount	Weighted Average Rate	Multi-family Amount	Weighted Average Rate	Home Equity Amount	Weighted Average Rate	Construction and Land Amount	Weighted Average Rate
	(Dollars in Thousands)							
2014	$38,910	5.38 %	$37,561	5.64 %	$9,378	4.18 %	$6,761	4.51 %
2015	6,889	4.83 %	24,105	5.03 %	7,310	4.01 %	4,574	3.90 %
2016	9,216	4.85 %	16,116	4.77 %	3,806	5.34 %	5,867	3.57 %
2017	3,244	4.44 %	27,985	3.98 %	1,689	5.45 %	177	4.44 %
2018	7,018	3.95 %	65,504	4.11 %	3,463	5.09 %	6,999	3.79 %
2019 and thereafter	348,337	4.84 %	350,326	5.01 %	9,786	4.01 %	7,527	4.58 %
Total	$413,614	4.87 %	$521,597	4.88 %	$35,432	4.37 %	$31,905	4.11 %

Due during the year ended December 31,	Commercial Real Estate Amount	Weighted Average Rate	Commercial Business Amount	Weighted Average Rate	Consumer Amount	Weighted Average Rate	Total Amount	Weighted Average Rate
	(Dollars in Thousands)							
2014	$3,240	5.68 %	$7,002	5.43 %	$106	6.49 %	102,958	5.35 %
2015	5,342	5.28 %	1,661	5.58 %	-	-	49,881	4.80 %
2016	14,950	5.57 %	652	5.92 %	28	4.56 %	50,635	4.94 %
2017	6,436	4.82 %	861	5.07 %	-	-	40,392	4.24 %
2018	10,649	4.33 %	3,494	4.74 %	-	-	97,127	4.16 %
2019 and thereafter	31,081	5.18 %	4,626	4.99 %	-	-	751,683	4.92 %
Total	$71,698	5.13 %	$18,296	5.20 %	$134	4.71 %	$1,092,676	4.86 %

The following table sets forth the scheduled repayments of fixed and adjustable rate loans at December 31, 2013 that are contractually due after December 31, 2014.

	Due After December 31, 2014		
	Fixed	Adjustable	Total
	(In Thousands)		
Mortgage loans			
Real estate loans:			
One- to four-family	$19,203	$355,501	$374,704
Multi-family	85,444	398,592	484,036
Home equity	5,986	20,068	26,054
Construction and land	11,940	13,204	25,144
Commercial	34,156	34,302	68,458
Commercial	10,151	1,143	11,294

Consumer	28	-	28
Total loans	$166,908	$822,810	$989,718

One- to Four-Family Residential Mortgage Loans. WaterStone Bank's primary lending activity is originating residential mortgage loans secured by properties located in Milwaukee and surrounding counties. One- to four-family residential mortgage loans totaled $413.6 million, or 37.9% of total loans at December 31, 2013. One- to four-family residential mortgage loans originated for investment during the year ended December 31, 2013 totaled $24.5 million, or 17.5% of all loans originated for investment. Our one- to four-family residential mortgage loans have fixed or adjustable rates. Our 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. We do not and have never offered residential mortgage loans specifically designed for borrowers with sub-prime credit scores, including Alt-A and negative amortization loans. Further, prior to 2007, we did not offer indexed, adjustable-rate loans other than home equity lines of credit, and we have never offered "teaser rate" first mortgage products.

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

All residential mortgage loans that we originate include "due-on-sale" clauses, which give us the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise transfers the real property subject to the mortgage and the loan is not repaid. We also require homeowner's insurance and where circumstances warrant, flood insurance, on properties securing real estate loans. The average single family first mortgage loan balance was $184,000 and the largest outstanding balance was $3.8 million on December 31, 2013. The average two- to four-family first mortgage loan balance was $154,000 on December 31, 2013, and the largest outstanding balance on that date was $5.0 million, which is a consolidation loan that is collateralized by 29 properties.

Multi-family Real Estate Loans. Multi-family loans totaled $521.6 million, or 47.8% of total loans at December 31, 2013. Multi-family loans originated during the year ended December 31, 2013 totaled $82.9 million, or 59.3% of all loans originated for investment. These loans are generally secured by properties located in our primary market area. Our multi-family real estate underwriting policies generally provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property provided the loan complies with our current loans-to-one borrower limit. Multi-family real estate loans are offered with interest rates that are fixed for periods of up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 30-year amortization period. In reaching a decision whether to make a multi-family real estate loan, we consider gross revenues and the net operating income of the property, the borrower's expertise and credit history, business 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. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, 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 by the principals and by the owners of 20% or more of the borrower.

A multi-family borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We generally require borrowers with aggregate outstanding balances exceeding $1.0 million to provide updated financial statements and federal tax returns annually. These requirements also apply to all guarantors on these loans. We also require borrowers with rental investment property to provide an annual report of income and expenses for the property, including a tenant list and copies of leases, as applicable. The average outstanding multi-family mortgage loan balance was $757,000 on December 31, 2013, with the largest outstanding balance at $7.9 million. At December 31, 2013, our largest exposure to one borrower or to a related group of borrowers was $23.9 million. The largest loan in the group is a mortgage loan with an outstanding balance at December 31, 2013 of $7.9 million.

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

Home Equity Loans and Lines of Credit. We also offer home equity loans and home equity lines of credit, both of which are secured by owner-occupied and non-owner occupied one- to four-family residences. At December 31, 2013, outstanding home equity loans and equity lines of credit totaled $35.4 million, or 3.2% of total loans outstanding. At December 31, 2013, the unadvanced portion of home equity lines of credit totaled $14.7 million. Home equity loans and lines originated during the year ended December 31, 2013 totaled $6.1 million, or 4.3% of all loans originated for investment. The underwriting standards utilized for home equity loans and home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan, and the value of the collateral securing the loan. Home equity loans are offered with adjustable rates of interest and with terms up to 10 years. The loan-to-value ratio for our home equity loans and our lines of credit is generally limited to 90% when combined with the first security lien, if applicable. Our home equity lines of credit have ten-year terms and adjustable rates of interest, subject to a contractual floor, which are indexed to the prime rate, as reported in The Wall Street Journal. Interest rates on home equity lines of credit are generally limited to a maximum rate of 18%. The average outstanding home equity loan balance was $50,000 at December 31, 2013, with the largest outstanding balance at that date of $862,000.

Residential Construction and Land Loans. We originate construction loans to individuals and contractors for the construction and acquisition of single and multi-family residences. At December 31, 2013, construction and land loans totaled $31.9 million, or 2.9% of total loans. Construction and land loans originated during the year ended December 31, 2013 totaled $6.7 million, or 4.8% of all loans originated for investment. At December 31, 2013, the unadvanced portion of these construction loans totaled $8.6 million.

Our construction mortgage loans generally provide for the payment of interest only during the construction phase, which is typically up to nine months although our policy is to consider construction periods as long as 12 months or more. At the end of the construction phase, the construction loan converts to a longer-term mortgage loan. Construction loans can be made with a maximum loan-to-value ratio of 90%, provided that the borrower obtains private mortgage insurance if the loan balance exceeds 80% of the lesser of the appraised value or sales price of the secured property. The average outstanding construction loan balance totaled $1.5 million on December 31, 2013, with the largest outstanding balance at $5.1 million. The average outstanding land loan balance was $297,000 on December 31, 2013, and the largest outstanding balance on that date was $4.0 million.

Before making a commitment to fund a residential 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 the percentage of completion method.

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 $71.7 million at December 31, 2013, or 6.6% of total loans, and are made up of loans secured by office and retail buildings, churches, restaurants, other retail properties and mixed use properties. Commercial real estate loans originated during the year ended December 31, 2013 totaled $12.1 million, or 8.6% of all loans originated for investment. These loans are generally secured by property located in our primary market area. Our commercial real estate underwriting policies provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property. Commercial real estate loans are offered with interest rates that are fixed up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 30-year amortization period. In reaching a decision whether to make a commercial real estate loan, we consider gross revenues and the net operating income of the property, the borrower's expertise and credit history, business 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. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, 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, 2013 was $481,000, and the largest outstanding balance at that date was $3.2 million.

Commercial Loans. Commercial loans totaled $18.3 million at December 31, 2013, or 1.7% of total loans, and are made up of loans secured by accounts receivable, inventory, equipment and real estate. Commercial loans originated during the year ended December 31, 2013 totaled $7.6 million, or 5.4% of all loans originated. In an effort to increase our commercial loan portfolio, we established a commercial loan department in 2007 and we currently have four commercial business loan officers.

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 working capital ratios 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, 2013, the unadvanced portion of working capital lines of credit totaled $10.4 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. These loans generally amortize over 15 to 25 years.

A commercial business borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, usually quarterly, payment history reviews and periodic face-to-face meetings with the borrower. The average outstanding commercial loan at December 31, 2013 was $178,000 and the largest outstanding balance on that date was $2.1 million.

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

	As of or for the Year Ended December 31,		
	2013	2012	2011
	(In Thousands)		
Total gross loans receivable and held for sale at beginning of year	$1,267,285	$1,304,947	$1,443,824
Real estate loans originated for investment:			
Residential			
One- to four-family	24,504	17,088	13,651
Multi-family	82,938	51,816	60,367
Home equity	6,079	3,112	4,328
Construction and land	6,676	2,695	3,487
Commercial real estate	12,098	14,572	25,398
Total real estate loans originated for investment	132,295	89,283	107,231
Consumer loans originated for investment	12	35	-
Commercial loans originated for investment	7,612	9,857	9,366
Total loans originated for investment	139,919	99,175	116,597
Real estate loans purchased for investment:			
One- to four-family	-	12,148	-
Home equity	-	3,338	-
Total real estate loans purchased for investment	-	15,486	-
Principal repayments	(154,739)	(164,392)	(200,074)
Transfers to real estate owned	(13,552)	(22,282)	(28,259)
Loan principal charged-off	(12,624)	(10,978)	(19,291)
Net activity in loans held for investment	(40,996)	(82,991)	(131,027)
Loans originated for sale	1,751,054	1,749,426	1,027,346
Loans sold	(1,787,646)	(1,704,097)	(1,035,196)

Net activity in loans held for sale	(36,592)	45,329	(7,850)
Total gross loans receivable and held for sale at end of year	$1,189,697	$1,267,285	$1,304,947

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, discretionary rate adjustments that are not tied to an independent index and pre-payment penalties.

Exclusive of our mortgage banking operations, we generally retain in our portfolio a significant majority of the loans that we originate. At December 31, 2013, WaterStone Bank was servicing $2.8 million in loan participations we 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 are authorized to approve and close any loan that qualifies under WaterStone Bank underwriting guidelines within the following lending limits:

- A secured one- to four-family mortgage loan up to $500,000 for a borrower with total outstanding loans from us of less than $1,000,000 that is independently underwritten can be approved by select loan officers.

- A loan up to $500,000 for a borrower with total outstanding loans from us of less than $500,000 can be approved by select commercial loan officers.

- Any secured mortgage loan ranging from $500,001 to $2,999,999 or any new loan to a borrower with outstanding loans from us exceeding $1,000,000 must be approved by the Officer Loan Committee.

- Any loan for $3,000,000 or more 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 $10,000,000 must be reviewed by the board of directors prior to closing.

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 such loans are placed on non-accrual status when they become more than 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.

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 collectibility 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 collectibility 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,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Non-accrual loans:					
Residential					
One- to four-family	$30,207	$46,467	$55,609	$56,759	$45,988
Multi-family	13,498	23,205	13,680	20,587	16,683
Home equity	1,585	1,578	1,334	712	1,159
Construction and land	4,195	2,215	6,946	3,013	6,269
Commercial real estate	938	668	514	1,577	2,773
Commercial	521	511	135	1,530	2,441
Consumer	17	24	-	-	-
Total non-accrual loans	50,961	74,668	78,218	84,178	75,313
Real estate owned					
One- to four-family	12,980	17,353	27,449	28,142	27,016
Multi-family	3,040	9,890	16,231	14,903	8,824
Construction and land	6,258	7,029	8,796	9,926	10,458
Commercial real estate	385	1,702	4,194	4,781	4,631
Total real estate owned	22,663	35,974	56,670	57,752	50,929
Total non-performing assets	$73,624	$110,642	$134,888	$141,930	$126,242

Total accruing troubled debt restructurings	$10,336		$16,011		$24,589		$33,592		$42,730	
Total non-accrual loans to total loans, net	4.66	%	6.59	%	6.43	%	6.44	%	5.30	%
Total non-accrual loans and accruing troubled debt restructurings to total loans receivable	5.61	%	8.00	%	8.45	%	9.01	%	8.31	%
Total non-accrual loans to total assets	2.62	%	4.50	%	4.57	%	4.65	%	4.03	%
Total non-performing assets to total assets	3.78	%	6.66	%	7.88	%	7.85	%	6.76	%

All loans that exceed 90 days with respect to past due principal and interest are recognized as non-accrual. Troubled debt restructurings which are still on nonaccrual either due to being past due greater than 90 days, 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 contractual past due dates 60 and 90 days. 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 year indicated.

	At December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Balance at beginning of year	$74,668	$78,218	$84,178	$75,313	$107,730
Additions	33,488	44,617	59,703	87,349	76,435
Transfers to real estate owned	(13,552)	(22,282)	(28,259)	(41,781)	(54,072)
Charge-offs	(11,792)	(8,379)	(14,138)	(24,395)	(23,541)
Returned to accrual status	(26,005)	(8,194)	(12,021)	(7,936)	(17,601)
Principal paydowns and other	(5,846)	(9,312)	(11,245)	(4,372)	(13,638)
Balance at end of year	$50,961	$74,668	$78,218	$84,178	$75,313

Total non-accrual loans decreased by $23.7 million, or 31.7%, to $51.0 million as of December 31, 2013 compared to $74.7 million as of December 31, 2012. The ratio of non-accrual loans to total loans receivable was 4.66% at December 31, 2013 compared to 6.59% at December 31, 2012. During the year ended December 31, 2013, $26.0 million in loans were returned to accrual status, $13.6 million were transferred to real estate owned (net of charge-offs), $11.8 million in loan principal was charged off and $5.8 million in principal payments were received. Offsetting this activity, $33.5 million in loans were placed on non-accrual status during the year ended December 31, 2013.

Of the $51.0 million in total non-accrual loans as of December 31, 2013, $45.0 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 $9.7 million in partial charge-offs have been recorded with respect to these loans as of December 31, 2013. 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 $5.1 million have been recorded as of December 31, 2013. The remaining $5.9 million of non-accrual loans were reviewed on an aggregate basis and $1.6 million in general valuation allowance was deemed necessary related to those loans as of December 31, 2013. The $1.6 million in general valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

Our largest non-accrual loan as of December 31, 2013 was collateralized by multi-family residential real estate located in southeastern Wisconsin. This loan had a principal balance of $3.8 million at December 31, 2013 and a specific valuation allowance of $525,000. Our second largest non-accrual loan as of December 31, 2013 was collateralized by a single-family residence located in Idaho. This loan had a principal balance of $1.7 million at December 31, 2013. Based upon an updated valuation, the estimated net realizable value of the collateral exceeds the principal balance of the loan, thus a specific valuation was not deemed necessary as of December 31, 2013. Our third largest non-accrual loan as of December 31, 2013 was collateralized by a single-family residence located in southeastern Wisconsin. This loan had a principal balance of $1.6 million and a specific valuation allowance of $418,000 at December 31, 2013. Our fourth largest non-accrual loan as of September 30, 2013 was collateralized by multi-family real estate located in southeastern Wisconsin with a principal balance of $1.5 million and a specific valuation of $236,000. Our next largest non-accrual loan as of December 31, 2013 was collateralized by improved land held for development, located in southeastern Wisconsin. This loan had a principal balance of $1.4 million at December 31, 2013, which is net of life-to-date charge offs of $1.5 million. Together, these five largest non-accrual loans comprised 19.9% of total non-accrual loans at December 31, 2013.

For the year ended December 31, 2013, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was $3.2 million. We recognized $2.1 million of interest income on such loans during the year ended December 31, 2013.

There were no accruing loans past due 90 days or more during the years ended December 31, 2013, 2012 or 2011.

Troubled Debt Restructurings.

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

	At December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Troubled debt restructurings					
Substandard	$25,258	$48,449	$47,220	$15,769	$18,003
Watch	4,329	11,172	8,192	20,703	34,082
Total troubled debt restructurings	$29,587	$59,621	$55,412	$36,472	$52,085

Troubled debt restructurings totaled $29.6 million at December 31, 2013, compared to $59.6 million at December 31, 2012. At December 31, 2013, $23.7 million of troubled debt restructurings, or 80.2%, were performing in accordance with their restructured terms. All troubled debt restructurings are considered to be impaired and are risk rated as either substandard or watch and are included in the internal risk rating tables disclosed in the notes to the consolidated financial statements. Specific reserves have been established to the extent that the collateral-based impairment analyses indicate that a collateral shortfall exists or to the extent that a discounted cash flow analysis results in an impairment.

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

	At December 31,			
	2013		2012	
	Accruing	Non-accruing	Accruing	Non-accruing
	(In Thousands)			
One- to four-family	$6,218	$ 11,875	$9,921	$ 21,847
Over four-family	2,710	5,314	3,917	20,030
Home equity	-	972	-	986
Construction and land	1,408	833	2,173	79
Commercial real estate	-	257	-	668
	$10,336	$ 19,251	$16,011	$ 43,610

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

	At or for the Year Ended December 31,			
	2013		2012	
	Accruing	Non-accruing	Accruing	Non-accruing
	(In Thousands)			
Balance at beginning of year	$16,011	$ 43,610	$24,589	$ 30,823
Additions	230	1,489	3,651	24,049
Change in accrual status	4,684	(4,684)	(2,060)	2,060
Charge-offs	-	(2,459)	(270)	(1,795)
Returned to contractual/market terms	(9,453)	(13,848)	(8,773)	(8,502)
Transferred to real estate owned	-	(3,094)	(125)	(1,009)
Principal paydowns and other	(1,136)	(1,763)	(1,001)	(2,016)
Balance at end of period	$10,336	$ 19,251	$16,011	$ 43,610

For the year ended December 31, 2013, gross interest income that would have been recorded had our troubled debt restructurings been current in accordance with their contractual terms was $1.9 million. We recognized $1.5 million of interest income on such loans during the year ended December 31, 2013.

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.

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

	At December 31,	
	2013	2012
	(Dollars in Thousands)	
Loans past due less than 90 days	$13,231	$23,092
Loans past due 90 days or more	30,780	51,358
Total loans past due	$44,011	$74,450
Total loans past due to total loans receivable	4.03 %	6.57 %

Past due loans decreased by $30.4 million, or 40.9%, to $44.0 million at December 31, 2013 from $74.5 million at December 31, 2012. Loans past due 90 days or more decreased by $20.6 million, or 40.1%, during the year ended December 31, 2013 while loans past due less than 90 days decreased by $9.9 million, or 42.7%. The $20.6 million decrease in loans past due 90 days or more was primarily due to an $11.0 million lending relationship that was brought current during the year ended December 31, 2013. The $9.9 million decrease in loans past due less than 90 days or more was primarily attributable to a $6.9 million decrease in loans collateralized by one- to four –family loans.

Real Estate Owned.

Total real estate owned decreased by $13.3 million, or 37.0%, to $22.7 million at December 31, 2013, compared to $36.0 million at December 31, 2012. During the year ended December 31, 2013, $13.6 million was transferred from loans to real estate owned upon completion of foreclosure. Declines in property values evidenced by updated appraisals, responses to list prices on properties held for sale and/or deterioration in the condition of properties resulted in write-downs totaling $1.4 million during the year ended December 31, 2013. During the same period, sales of real estate owned totaled $25.7 million, resulting in a net gain of $2.8 million.

In an effort to strengthen our oversight of problem assets and minimize overall costs and expenses as well as any loss on the sale of real estate owned, during 2011 we established an internal asset management group and an internal sales group, which also enable our lenders to focus on loan origination instead of foreclosed asset management.

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 (as described previously) 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 us).

We owned 158 properties at December 31, 2013, compared to 223 properties as of December 31, 2012 and 323 properties at December 31, 2011. Habitable real estate owned is managed with the intent of attracting a lessee to generate revenue. Foreclosed properties are recorded at the lower of carrying value or fair 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 asset. 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 assets 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,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Balance at beginning of year	$31,043	$32,430	$29,175	$28,494	$25,167
Provision for loan losses	4,532	8,300	22,077	25,832	26,687
Charge-offs:					
Mortgage loans					
One- to four-family	8,706	6,472	11,553	16,906	13,602
Multi-family	1,640	1,108	3,996	3,439	3,304
Home equity	630	485	634	619	861
Construction and land	1,480	1,668	1,745	2,319	3,957
Commercial real estate	160	1,182	734	575	910
Consumer	-	4	10	13	9
Commercial	8	59	619	1,470	1,000
Total charge-offs	12,624	10,978	19,291	25,341	23,643
Recoveries:					
Mortgage loans					
One- to four-family	957	667	311	127	181
Multi-family	258	56	40	55	23
Home equity	35	25	7	3	1
Construction and land	51	250	69	2	77
Commercial real estate	-	-	6	1	-
Consumer	6	-	1	1	1
Commercial	6	293	35	1	-
Total recoveries	1,313	1,291	469	190	283
Net charge-offs	11,311	9,687	18,822	25,151	23,360
Allowance at end of year	$24,264	$31,043	$32,430	$29,175	$28,494
Ratios:					
Allowance for loan losses to non-performing loans at end of year	47.61 %	41.58 %	41.46 %	34.66 %	37.83 %
Allowance for loan losses to net loans outstanding at end of year	2.22 %	2.74 %	2.67 %	2.23 %	2.01 %
Net charge-offs to average loans outstanding	0.94 %	0.76 %	1.43 %	1.75 %	1.54 %
Current year provision for loan losses to net charge-offs	40.07 %	85.68 %	117.29 %	102.71 %	114.24 %
Net charge-offs to beginning of the year allowance	36.44 %	29.87 %	64.51 %	88.27 %	92.82 %

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, 2013			2012			2011		
	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	$11,549	37.85 %	47.59 %	$17,819	40.65 %	57.40 %	$17,475	40.83 %	53.89 %
Multi-family	7,211	47.75 %	29.72 %	7,734	45.37 %	24.90 %	8,252	45.39 %	25.44 %
Home equity	1,807	3.24 %	7.45 %	2,097	3.22 %	6.76 %	1,998	3.17 %	6.16 %
Construction and land	1,613	2.92 %	6.65 %	1,323	2.98 %	4.26 %	2,922	3.25 %	9.01 %
Commercial real estate	1,402	6.56 %	5.78 %	1,259	5.78 %	4.06 %	941	5.38 %	2.90 %
Commercial	34	1.67 %	0.14 %	781	1.99 %	2.52 %	814	1.97 %	2.51 %
Consumer	648	0.01 %	2.67 %	30	0.01 %	0.10 %	28	0.01 %	0.09 %
Total allowance for loan losses	$24,264	100.00 %	100.00 %	$31,043	100.00 %	100.00 %	$32,430	100.00 %	100.00 %

	At December 31, 2010			2009		
	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	$16,150	44.56 %	55.36 %	$17,875	47.86 %	62.73 %
Multi-family	6,877	41.53 %	23.57 %	5,208	37.80 %	18.28 %
Home equity	1,196	3.53 %	4.10 %	1,642	4.06 %	5.76 %
Construction and land	3,252	4.13 %	11.14 %	2,635	4.36 %	9.25 %
Commercial real estate	671	3.96 %	2.30 %	720	3.45 %	2.53 %
Commercial	1,001	2.28 %	3.43 %	371	2.43 %	1.30 %
Consumer	28	0.01 %	0.10 %	43	0.04 %	0.15 %
Total allowance for loan losses	$29,175	100.00 %	100.00 %	$28,494	100.00 %	100.00 %

All impaired loans meeting the criteria established by management are evaluated either 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.

The above analysis is both quantitative and subjective, as it requires us to make estimates that are susceptible to revisions as more information becomes available. Although we believe that we have established the allowance at levels appropriate to absorb probable and estimable losses, additions may be necessary if future economic conditions differ substantially from the current environment.

At December 31, 2013, the allowance for loan losses was $24.3 million, compared to $31.0 million at December 31, 2012. As of December 31, 2013, the allowance for loan losses to total loans receivable was 2.22% and equal to 47.61% of non-performing loans, compared to 2.74%, and 41.58%, respectively at December 31, 2012. The decrease in the allowance for loan losses during the year ended December 31, 2013 reflects a stabilization in both the quality of the loan portfolio as well as the overall local real estate market. During each period we experienced a stabilization or improvement in a number of key loan-related loan quality metrics, including impaired loans, substandard loans, loans contractually past due and non-accrual loans. In addition, the decrease in the allowance for loan losses reflects a decrease in the overall balance of loans outstanding.

Net charge-offs totaled $11.3 million, or an annualized 0.93% of average loans for the year ended December 31, 2013, compared to $9.7 million, or an annualized 0.76% of average loans for the year ended December 31, 2012. The $1.6 million increase in net charge-offs was primarily the result of an increase in charge-offs related to loans secured by one- to four-family residential loans, which increased $1.9 million, or 33.5%, to $7.7 million for year ended December 31, 2013, as compared to $5.8 million for the year ended December 31, 2012. The increase in net charge-offs reflects $1.4 million in charge-offs related to one borrower with six loans. The $1.4 million had been included in specific reserves as of December 31, 2012.

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 quantified deterioration of the credit quality of our loan portfolio as described above is the direct result of borrowers who were not financially strong enough to make regular interest and principal payments or maintain their properties when the economic environment no longer allowed them the option of converting estimated real estate value increases into short-term cash flow.

Mortgage Banking Activity

In addition to the lending activities previously discussed, we also originate residential mortgage loans for sale in the secondary market through Waterstone Mortgage Corporation. We originated $1.75 billion in mortgage loans held for sale during the year ended December 31, 2013, which was consistent with the $1.75 billion originated during the year ended December 31, 2012. Proceeds from sales to third parties during the years ended December 31, 2013 and 2012 totaled $1.86 billion and $1.79 billion, respectively. Margins earned on loans sold declined during the year ended December 31, 2013 such that total mortgage banking segment revenues declined $3.1 million, or 3.5%, to $84.9 million during the year ended December 31, 2013 compared to $87.9 million during the year ended December 31, 2012. We sell loans on both a servicing-released and a servicing retained basis. Waterstone Mortgage Corporation has contracted with a third party to service the loans for which we retain servicing.

Our overall margin can be affected by the mix of both loan type (conventional loans versus governmental) and loan purpose (purchase versus refinance). Conventional loans include loans that conform to Fannie Mae and Freddie Mac standards, whereas governmental loans are those loans guaranteed by the federal government, such as a Federal Housing Authority or U.S. Department of Agriculture loan. During the year ended December 31, 2013, the growth in loan origination volume resulted in a shift towards higher yielding governmental loans and loans originated for the purchase of a residential property, however, margins decreased for all loan types and loan purpose, compared to the year ended December 31, 2012. Loans originated for the purchase of a residential property, which generally yield a higher margin than loans originated for refinancing existing loans, comprised 67.9% of total originations during the year ended December 31, 2013, compared to 55.4% of total originations during the year ended December 31, 2012. The mix of loan type has changed slightly with conventional loans and governmental loans comprising 62.7% and 37.3% of all loan originations, respectively, during the year ended December 31, 2013, compared 67.3% and 32.7% of all loan originations, respectively, during the year ended December 31, 2012.

Partially offsetting the decline in revenues related to the origination and sale of loans during the year ended December 31, 2013, the Company sold mortgage servicing rights related to $541.6 million in loans receivable with a book value $2.8 million at a gain of $2.6 million. The sales were timed to take advantage of preferable market pricing conditions. There were no comparable transactions during the year ended December 31, 2012.

Operating expenses related to our mortgage banking segment increased $7.1 million, or 10.3% to $76.2 million during the year ended December 31, 2013, compared to $69.1 million during the year ended December 31, 2012. The increase in operating expenses resulted from the expansion of our branch network as well as an increase in support staffing levels during the end of 2012 and beginning half of 2013 in anticipation of increased volumes. During the quarter ended December 31, 2013, the Company reduced support staffing levels in response to lower than anticipated origination volumes. The anticipated increase in origination volumes did not materialize during the last six months of the year due in large part to the significant increase in interest rates on in fixed-rate mortgages during the year which led to lower demand for refinance mortgage products. Compensation expense associated with our mortgage banking activities increased by $4.7 million, or 9.3%, to $55.5 million during the year ended December 31, 2013 compared to $50.7 million for the year ended December 31, 2012. Occupancy expense increased $1.3 million, or 34.7%, to $5.2 million during the year ended December 31, 2013 compared to $3.9 million during the year ended December 31, 2012. The increases resulted from an expansion of the branch network as well as the relocation of the mortgage banking segment's corporate headquarters to a larger leased facility.

Investment Activities

Wauwatosa Investments, Inc. is WaterStone Bank's investment subsidiary headquartered in the State of Nevada. Wauwatosa Investments, Inc. manages WaterStone Bank's investment portfolio. Our Treasurer and Treasury Officer are responsible for implementing 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 our 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 Treasurer and Treasury Officer who may act jointly or severally. In addition, the President of Wauwatosa Investments, Inc. has execution authority for securities transactions. The Treasurer 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 Treasurer, the Treasury Officer and the President of Wauwatosa Investments, Inc. are authorized to execute investment transactions (purchases and sales) without the prior approval of the board and 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 year ended December 31, 2013, municipal securities with a total book value of $930,000 were sold at a loss of $9,000. During the year ended December 31, 2012, collateralized mortgage obligations with a total book value of $18.0 million were sold at a gain of $282,000 and municipal securities with a total book value of $11.6 million were sold at a gain of $240,000. During the year ended December 31, 2011, collateralized mortgage obligations with a total book value of $3.2 million were sold at a gain of $53,000.

Available for Sale Portfolio

Government Sponsored Enterprise Bonds. At December 31, 2013, our Government sponsored enterprise bond portfolio totaled $17.9 million, all of which were issued by Federal National Mortgage Associated (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac) or Federal Home Loan Bank (FHLB) and were classified as available for sale. The weighted average yield on these securities was 1.08% and the weighted average remaining average life was 4.0 years at December 31, 2013. 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, 2013 was $237,000 less than the amortized cost of $18.2 million. A total of $988,000 of government enterprise bonds are pledged as collateral for borrowings at December 31, 2013.

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 and collateralized mortgage obligations issued by investment banks. We invest in mortgage-backed securities and collateralized mortgage obligations to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk. We regularly monitor the credit quality of this portfolio.

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

At December 31, 2013, mortgage-backed securities totaled $104.9 million. The mortgage-backed securities portfolio had a weighted average yield of 2.17% and a weighted average remaining life of 3.9 years at December 31, 2013. The estimated fair value of our mortgage-backed securities portfolio at December 31, 2013 was $461,000 more than the amortized cost of $104.5 million. Mortgage-backed securities valued at $80.4 million are pledged as collateral for borrowings at December 31, 2013. 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 market 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, 2013, collateralized mortgage obligations totaled $19.2 million. At December 31, 2013, 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 2.45% and a weighted average remaining life of 2.4 years at December 31, 2013. The estimated fair value of our collateralized mortgage obligations portfolio at December 31, 2013 was $295,000 more than the amortized cost of $18.9 million. Collateralized mortgage obligations valued at $19.2 million are pledged as collateral for borrowings at December 31, 2013. 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 market value of such securities may be adversely affected in a rising interest rate environment, particularly since all of our collateralized mortgage obligations have a fixed rate of interest. The relatively short weighted average remaining life of our collateralized mortgage obligation portfolio mitigates our potential risk of loss in a rising interest rate environment.

Municipal Obligations. These securities consist of obligations issued by school districts, counties and municipalities or their agencies and include general obligation bonds, industrial development revenue bonds and other revenue bonds. Our Investment Policy requires that such municipal obligations be rated A+ or better by a nationally recognized rating agency at the date of purchase. A security that is downgraded below investment grade will require additional analysis of creditworthiness and a determination will be made to hold or dispose of the investment. At December 31, 2013, our municipal obligations portfolio totaled $58.8 million, all of which was classified as available for sale. The weighted average yield on this portfolio was 3.97% at December 31, 2013, with a weighted average remaining life of 8.9 years. The estimated market value of our municipal obligations bond portfolio at December 31, 2013 was $2.2 million less than the amortized cost of $61.0 million. During the year ended December 31, 2012, the Company identified two municipal securities that were deemed to be other-than-temporarily impaired. Both securities were issued by a tax incremental district in a municipality located in Wisconsin. During the year ended December 31, 2012, the Company's analysis of these securities resulted in $100,000 in credit losses that were charged to earnings with respect to these two municipal securities. No additional other-than-temporary impairment was deemed necessary during the year ended December 31, 2013. As of December 31, 2013, these securities had a combined amortized cost of $215,000 and a combined estimated fair value of $189,000.

Other Debt Securities. As of December 31, 2013, we held a trust preferred security with a fair value of $5.2 million and amortized cost of $5.0 million. This security, which yields 10.0% is callable beginning in the second quarter of 2013 with final maturity in 2068.

Certificates of Deposit. At December 31, 2013, we held certificates of deposit with a fair value and amortized cost of $7.4 million. The weighted average yield on these securities was 1.05% and the weighted average remaining average life was 1.9 years at December 31, 2013. While these certificates 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.

Investment Securities Portfolio.

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

	At December 31,					
	2013		2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)					
Securities available for sale:						
Mortgage-backed securities	$104,462	104,923	$116,813	119,056	$33,561	35,417
Collateralized mortgage obligations						
Government sponsored enterprise issued	18,946	19,241	29,207	29,579	32,650	33,196
Private label issued	-	-	-	-	19,475	18,451
Government sponsored enterprise bonds	18,171	17,934	8,000	8,017	71,210	71,349
Municipal obligations	61,014	58,793	35,493	37,371	37,644	39,068
Other debt securities	5,000	5,160	5,000	5,070	5,000	5,118
Certificates of deposit	7,350	7,367	5,880	5,924	3,920	3,920
Total securities available for sale	$214,943	213,418	$200,393	205,017	$203,460	206,519

The following table sets forth the amortized cost and estimated fair value of securities, by issuer, as of December 31, 2013, that exceeded 10% of our stockholders' equity as of that date.

	At December 31, 2013	
	Amortized Cost	Fair Value
	(In Thousands)	
Fannie Mae	$99,227	$99,480
Freddie Mac	35,655	36,033

Portfolio Maturities and Yields. The composition and maturities of the securities portfolio at December 31, 2013 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	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
	(Dollars in Thousands)									
Securities available for sale:										
Mortgage-backed securities	-	-	$101,490	2.13 %	-	-	$3,433	3.17 %	$104,923	2.17 %
Collateralized mortgage obligations										
Government sponsored enterprise issued	$361	5.31 %	18,880	2.39 %	-	-	-	-	19,241	2.45 %
Government sponsored enterprise bonds	-	-	17,934	1.08 %	-	-	-	-	17,934	1.08 %
Municipal obligations	666	3.52 %	10,983	4.72 %	$21,135	2.85 %	26,009	4.60 %	58,793	3.97 %
Other debt securities	-	-	-	-	-	-	5,160	10.00 %	5,160	10.00 %
Certificates of deposit	1,966	0.93 %	5,401	1.09 %	-	-	-	-	7,367	1.05 %
Total securities available for sale	$2,993	2.02 %	$154,688	2.18 %	$21,135	2.85 %	$34,602	5.20 %	$213,418	2.76 %

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 who work or reside 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, 2013, regular savings accounts included $388.7 million in deposits from our second-step offering and comprised 31.2% of total customer deposits at December 31, 2013, with a weighted average cost of 0.01%. Excluding the deposits received in connection with the stock offering, certificates of deposit comprised 74.5% of total customer deposits at December 31, 2013, and had a weighted average cost of 0.69% 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, 2013 and December 31, 2012, $637.8 million and $736.9 million of our deposit accounts were certificates of deposit, of which $505.8 million and $454.6 million, respectively, had maturities of one year or less. The percentage of our deposit accounts that are certificates of depos