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Waterstone Financial, Inc.
Form 10-Q
May 01, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

T Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2015

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

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) (IRS Employer Identification No.)

11200 W. Plank Court Wauwatosa, Wisconsin 53226
(Address of principal executive offices) (Zip Code)

(414) 761-1000
(Registrant's telephone number, including area code)

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 T No

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

Yes T No

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 Accelerated filer T Non-accelerated filer Smaller reporting company
(Do not check if smaller reporting company)

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

Yes No T

The number of shares outstanding of the issuer's common stock, \$0.01 par value per share, was 33,574,374 at April 30, 2015.

WATERSTONE FINANCIAL, INC.

10-Q INDEX

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PART I — FINANCIAL INFORMATION

Item 1. Financial StatementsWATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	(Unaudited)	
	March 31, 2015	December 31, 2014
	(In Thousands, except share data)	
Assets		
Cash	\$100,116	145,846
Federal funds sold	32,468	21,268
Interest-earning deposits in other financial institutions and other short term investments	9,809	5,706
Cash and cash equivalents	142,393	172,820
Securities available for sale (at fair value)	275,107	273,443
Loans held for sale (at fair value)	164,848	125,073
Loans receivable	1,064,758	1,094,990
Less: Allowance for loan losses	17,767	18,706
Loans receivable, net	1,046,991	1,076,284
Office properties and equipment, net	25,070	25,562
Federal Home Loan Bank stock (at cost)	17,500	17,500
Cash surrender value of life insurance	51,055	50,848
Real estate owned	19,579	18,706
Prepaid expenses and other assets	23,505	23,144
Total assets	\$1,766,048	1,783,380
Liabilities and Shareholders' Equity		
Liabilities:		
Demand deposits	\$96,806	92,162
Money market and savings deposits	118,727	119,163
Time deposits	639,201	652,635
Total deposits	854,734	863,960
Short-term borrowings	50,000	-
Long-term borrowings	384,000	434,000
Advance payments by borrowers for taxes	9,058	4,991
Other liabilities	18,935	30,192
Total liabilities	1,316,727	1,333,143
Shareholders' equity:		
Preferred stock (par value \$.01 per share)		
Authorized - 50,000,000 shares in 2015 and 50,000,000 in 2014, no shares issued	-	-
Common stock (par value \$.01 per share)		
Authorized - 100,000,000 shares in 2015 and 100,000,000 in 2014		
Issued - 34,564,687 in 2015 and 34,420,094 in 2014		
Outstanding - 34,564,687 in 2015 and 34,420,094 in 2014	346	344
Additional paid-in capital	315,343	313,894

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Retained earnings	158,709	157,304
Unearned ESOP shares	(22,255)	(22,552)
Accumulated other comprehensive income, net of taxes	2,524	1,247
Cost of shares repurchased (412,462 shares in 2015 and 0 shares in 2014)	(5,346)	-
Total shareholders' equity	449,321	450,237
Total liabilities and shareholders' equity	\$1,766,048	1,783,380

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three months ended March 31,	
	2015	2014
	(In Thousands, except per share amounts)	
Interest income:		
Loans	\$13,313	13,669
Mortgage-related securities	839	559
Debt securities, federal funds sold and short-term investments	866	825
Total interest income	15,018	15,053
Interest expense:		
Deposits	1,353	1,060
Borrowings	4,229	4,293
Total interest expense	5,582	5,353
Net interest income	9,436	9,700
Provision for loan losses	335	250
Net interest income after provision for loan losses	9,101	9,450
Noninterest income:		
Service charges on loans and deposits	406	254
Increase in cash surrender value of life insurance	207	146
Mortgage banking income	21,039	14,503
Gain on sale of available for sale securities	44	-
Other	337	2,155
Total noninterest income	22,033	17,058
Noninterest expenses:		
Compensation, payroll taxes, and other employee benefits	18,078	15,059
Occupancy, office furniture, and equipment	2,443	2,685
Advertising	653	736
Data processing	575	559
Communications	370	422
Professional fees	497	508
Real estate owned	543	548
FDIC insurance premiums	336	406
Other	2,933	2,709
Total noninterest expenses	26,428	23,632
Income before income taxes	4,706	2,876
Income tax expense	1,690	993
Net income	\$3,016	1,883
Income per share:		
Basic	\$0.09	0.05
Diluted	\$0.09	0.05
Weighted average shares outstanding:		
Basic	32,369	34,264
Diluted	32,650	34,503

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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WATERSONE FINANCIAL, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

	Three months ended March 31,	
	2015	2014
	(In Thousands)	
Net income	\$3,016	1,883
Other comprehensive income, net of tax:		
Net unrealized holding gain on available for sale securities:		
Net unrealized holding gain arising during the period, net of tax expense of \$(843) and \$(922) respectively	1,304	1,427
Reclassification adjustment for net gain included in net income during the period, net of tax expense of \$17 and \$0, respectively	(27)	0
Total other comprehensive income	1,277	1,427
Comprehensive income	\$4,293	3,310

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

	Common Stock Shares	Additional Paid-In Capital (In Thousands)	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Treasury Shares	Cost of Shares Repurchased	Total Shareholders' Equity
Balances at December 31, 2013	31,349	\$341	110,480	(854)	(1,429)	(45,261)	-	214,472
Comprehensive income:								
Net income	-	-	1,883	-	-	-	-	1,883
Other comprehensive income	-	-	-	-	1,427	-	-	1,427
Total comprehensive income								3,310
ESOP shares committed to be released to Plan participants	-	5	-	214	-	-	-	219
Stock based compensation	(16)	95	-	-	-	-	-	95
Merger of Lamplighter, MHC	(23,050)	(231)	305	-	-	-	-	74
Exchange of common stock	(8,299)	(83)	83	-	-	-	-	-
Treasury stock retired	-	(27)	(45,234)	-	-	45,261	-	-
Proceeds of stock offering, net of costs	34,406	344	248,004	-	-	-	-	248,348
Balances at March 31, 2014	34,390	\$344	313,738	(640)	(2)	-	-	466,518
Balances at December 31, 2014	34,420	\$344	313,894	(22,552)	1,247	-	-	450,237

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Comprehensive income:									
Net income	-	-	-	3,016	-	-	-	-	3,016
Other comprehensive income	-	-	-	-	-	1,277	-	-	1,277
Total comprehensive income									4,293
ESOP shares committed to be released to Plan participants	-	-	43	-	297	-	-	-	340
Cash dividend, \$0.05 per share	-	-	-	(1,611)	-	-	-	-	(1,611)
Stock based compensation	557	6	30	-	-	-	-	-	36
Stock compensation expense	-	-	1,376	-	-	-	-	-	1,376
Purchase of common stock returned to authorized but unissued	(412)	(4)	-	-	-	-	-	(5,346)	(5,350)
Balances at March 31, 2015	34,565	\$346	315,343	158,709	(22,255)	2,524	-	(5,346)	449,321

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended March 31,	
	2015	2014
	(In Thousands)	
Operating activities:		
Net income	\$3,016	1,883
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	335	250
Provision for depreciation	798	803
Stock based compensation	1,376	95
Net amortization of premium/discount on debt and mortgage related securities	343	401
Amortization of unearned ESOP shares	340	219
Amortization and impairment of mortgage servicing rights	177	121
Gain on sale of loans held for sale	(19,868)	(12,613)
Loans originated for sale	(398,990)	(295,266)
Proceeds on sales of loans originated for sale	379,083	298,051
Increase in accrued interest receivable	(185)	(213)
Increase in cash surrender value of life insurance	(207)	(146)
Decrease in accrued interest on deposits and borrowings	(1)	(24)
Decrease in other liabilities	(1,706)	(206)
Increase in accrued tax payable	1,257	781
Gain on sale of available for sale securities	(44)	-
Net loss related to real estate owned	97	47
Gain on sale of mortgage servicing rights	(6)	(1,786)
Other	(2,677)	5,085
Net cash used in operating activities	(36,862)	(2,518)
Investing activities:		
Net decrease (increase) in loans receivable	22,060	(14,535)
Purchases of:		
Mortgage related securities	(10,485)	(9,524)
Certificates of deposit	-	(735)
Premises and equipment, net	(368)	(708)
Proceeds from:		
Principal repayments on mortgage-related securities	8,856	6,242
Maturities of debt securities	735	3,795
Sales of debt securities	1,034	-
Sales of real estate owned	6,243	3,781
Net cash provided by (used in) investing activities	28,075	(11,684)
Financing activities:		
Net decrease in deposits	(9,226)	(25,037)
Net change in short-term borrowings	-	(11,134)
Net change in advance payments by borrowers for taxes	(5,579)	(7,621)
Cash dividends on common stock	(1,515)	-
Purchase of common stock returned to authorized but unissued	(5,350)	-

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Proceeds from stock option exercises	30	-
Stock offering funds returned to subscribers	-	(141,882)
Net cash used in financing activities	(21,640)	(185,674)
Decrease in cash and cash equivalents	(30,427)	(199,876)
Cash and cash equivalents at beginning of period	172,820	429,169
Cash and cash equivalents at end of period	\$142,393	229,293

Supplemental information:

Cash paid or credited during the period for:

Income tax payments	457	52
Interest payments	5,583	5,376
Noncash activities:		
Loans receivable transferred to real estate owned	6,898	3,511
Deposits utilized to purchase common stock	-	253,000
Dividends declared but not paid in other liabilities	1,611	-

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 — Basis of Presentation

On June 6, 2013, the Board of Directors of Lamplighter Financial, MHC ("MHC") and the Board of Directors of Waterstone Financial, Inc., a federal corporation, ("Waterstone-Federal") adopted a Plan of Conversion and Reorganization (the "Plan"). Pursuant to the Plan, Waterstone Financial, Inc., a Maryland corporation, ("New Waterstone") was organized and the MHC converted from the mutual holding company form of organization to the fully public form on January 22, 2014. As part of the conversion, the MHC's ownership interest of Waterstone-Federal was offered for sale in a public offering. A total of 25,300,000 shares were sold in the offering at a price \$10.00 per share, resulting in gross proceeds of \$253.0 million. Expenses related to the offering totaled approximately \$4.7 million. The existing publicly held shares of Waterstone-Federal were exchanged for new shares of common stock of New Waterstone at a conversion ratio of 1.0973-to-one. The exchange ratio ensured that immediately after the conversion and public offering, the public shareholders of Waterstone-Federal owned the same aggregate percentage of New Waterstone common stock that they owned immediately prior to that time (excluding shares purchased in the stock offering and cash received in lieu of fractional shares). When the conversion and public offering was completed, New Waterstone became the holding company of WaterStone Bank SSB and succeeded to all of the business and operations of Waterstone-Federal and each of Waterstone-Federal and Lamplighter Financial, MHC ceased to exist. Approximately 34,405,458 shares of New Waterstone common stock were outstanding after the completion of the offering and exchange. The words "Waterstone Financial," "we" and "our" thus are intended to refer to Waterstone-Federal and its subsidiaries with respect to matters and time periods occurring on or before January 22, 2014, and to New Waterstone and its subsidiaries with respect to matters and time periods occurring thereafter.

The unaudited interim consolidated financial statements include the accounts of Waterstone Financial, Inc. (the "Company") and the Company's subsidiaries.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information, Rule 10-01 of Regulation S-X and the instructions to Form 10-Q. The financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position, results of operations, changes in shareholders' equity, and cash flows of the Company for the periods presented.

The accompanying unaudited consolidated financial statements and related notes should be read in conjunction with the Company's December 31, 2014 Annual Report on Form 10-K. Operating results for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015 or for any other period.

The preparation of the unaudited consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the allowance for loan losses, deferred income taxes and real estate owned. Actual results could differ from those estimates.

Certain prior period amounts have been reclassified to conform to current period presentation. These reclassifications did not result in any changes to previously reported net income or shareholders' equity.

Note 2— Securities Available for Sale

The amortized cost and fair values of the Company's investment in securities available for sale follow:

	March 31, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	\$109,606	2,433	(33)	112,006
Collateralized mortgage obligations:				
Government sponsored enterprise issued	66,254	585	(4)	66,835
Mortgage-related securities	175,860	3,018	(37)	178,841
Government sponsored enterprise bonds	6,750	10	(1)	6,759
Municipal securities	74,965	1,868	(125)	76,708
Other debt securities	7,403	226	-	7,629
Debt securities	89,118	2,104	(126)	91,096
Certificates of deposit	5,145	25	-	5,170
	\$270,123	5,147	(163)	275,107

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	December 31, 2014			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	\$115,670	1,582	(124)	) 117,128
Collateralized mortgage obligations:				
Government sponsored enterprise issued	58,821	320	(70)	) 59,071
Mortgage-related securities	174,491	1,902	(194)	) 176,199
Government sponsored enterprise bonds	6,750	2	(41)	) 6,711
Municipal securities	76,037	1,442	(371)	) 77,108
Other debt securities	7,404	159	(35)	) 7,528
Debt securities	90,191	1,603	(447)	) 91,347
Certificates of deposit	5,880	17	-	) 5,897
	\$270,562	3,522	(641)	) 273,443

The Company's mortgage-backed securities and collateralized mortgage obligations issued by government sponsored enterprises are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. At March 31, 2015, \$95.2 million of the Company's mortgage related securities were pledged as collateral to secure repurchase agreement obligations of the Company. As of March 31, 2015, \$1.3 million of municipal securities were pledged as collateral to secure mortgage banking related activities. At December 31, 2014, \$98.2 million of the Company's government sponsored enterprise bonds and \$1.3 million of the Company's mortgage related securities were pledged as collateral to secure mortgage banking related activities.

The amortized cost and fair values of investment securities by contractual maturity at March 31, 2015 are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Debt and other securities		
Due within one year	\$8,972	9,075
Due after one year through five years	21,609	21,931
Due after five years through ten years	42,149	42,696
Due after ten years	21,533	22,564
Mortgage-related securities	175,860	178,841
	\$270,123	275,107

Gross unrealized losses on securities available for sale and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows:

March 31, 2015					
Less than 12 months		12 months or longer		Total	
Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
(In Thousands)					

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Mortgage-backed securities	\$-	-	10,100	(33)	10,100	(33)	
Collateralized mortgage obligations:									
Government sponsored enterprise issued	2,048	(4	)	-	-	2,048	(4)	
Government sponsored enterprise bonds	-	-	1,999	(1	)	1,999	(1)	
Municipal securities	6,960	(28)	5,554	(97)	12,514	(125)
Certificates of deposit	-	-	-	-	-	-	-	-	
	\$9,008	(32)	17,653	(131)	26,661	(163)

	December 31, 2014								
	Less than 12 months		12 months or longer		Total				
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss			
	(In Thousands)								
Mortgage-backed securities	\$10,537	(13	)	12,489	(111	)	23,026	(124)
Collateralized mortgage obligations:									
Government sponsored enterprise issued	23,131	(70	)	-	-	23,131	(70)	
Government sponsored enterprise bonds	2,739	(11	)	2,970	(30	)	5,709	(41)
Municipal securities	5,671	(19	)	21,344	(352	)	27,015	(371)
Other debt securities	4,977	(35	)	-	-	4,977	(35)	
Certificates of deposit	490	-	-	-	-	490	-	-	
	\$47,545	(148	)	36,803	(493	)	84,348	(641)

The Company reviews the investment securities portfolio on a quarterly basis to monitor its exposure to other-than-temporary impairment. In evaluating whether a security's decline in market value is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, financial condition of the issuer and the underlying obligors, quality of credit enhancements, volatility of the fair value of the security, the expected recovery period of the security and ratings agency evaluations. In addition the Company may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds and the value of any underlying collateral.

As of March 31, 2015, the Company held two municipal securities that had previously been 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 received audited financial statements with respect to the municipal issuer that called into question the ability of the underlying taxing district that issued the securities to operate as a going concern. During the year ended December 31, 2012, the Company's analysis of these securities resulted in \$100,000 in credit losses that were charged to earnings with respect to these two municipal securities. An additional \$17,000 credit loss that was charged to earnings during the year ended December 31, 2014 for these municipal bonds. During the year ended December 31, 2014, there were sales in the market of municipal issuer bonds at a discounted price that resulted in the Company recording additional credit losses. As of March 31, 2015, these securities had a combined amortized cost of \$198,000 and a combined estimated fair value of \$264,000.

As of March 31, 2015, the Company had 14 municipal securities, five mortgage-backed securities, one government sponsored enterprise issued, and one government sponsored enterprise bonds which had been in an unrealized loss position for twelve months or longer. These securities were determined not to be other-than-temporarily impaired as of March 31, 2015. The Company has determined that the decline in fair value of these securities is primarily attributable to an increase in market interest rates compared to the stated rates on these securities and is not attributable to credit deterioration. As the Company does not intend to sell nor is it more likely than not that it will be required to sell these securities before recovery of the amortized cost basis, these securities are not considered other-than-temporarily impaired.

Continued deterioration of general economic market conditions could result in the recognition of future other than temporary impairment losses within the investment portfolio and such amounts could be material to our consolidated financial statements.

During the three months ended March 31, 2015, proceeds from the sale of securities totaled \$1.0 million and resulted in gains totaling \$44,000. The \$44,000 included in gain on sale of available for sale securities in the consolidated statements of income during the three months ended March 31, 2015 was reclassified from accumulated other comprehensive income. There were no sales of securities during the three months ended March 31, 2014.

The following table presents the change in other-than-temporary credit related impairment charges on securities available for sale for which a portion of the other-than-temporary impairments related to other factors was recognized in other comprehensive loss.

	(In Thousands)
Credit-related impairments on securities as of December 31, 2013	\$ 100
Credit-related impairments related to securities for which an other- than-temporary impairment was not previously recognized	-
Increase in credit-related impairments related to securities for which an other-than-temporary impairment was previously recognized	17
Reduction for sales of securities for which other-than-temporary was previously recognized	-
Credit-related impairments on securities as of December 31, 2014	117

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Credit-related impairments related to securities for which an other- than-temporary impairment was not previously recognized	-
Increase in credit-related impairments related to securities for which an other-than-temporary impairment was previously recognized	-
Credit-related impairments on securities as of March 31, 2015	\$ 117

Note 3 - Loans Receivable

Loans receivable at March 31, 2015 and December 31, 2014 are summarized as follows:

	March 31, 2015	December 31, 2014
	(In Thousands)	
Mortgage loans:		
Residential real estate:		
One- to four-family	\$397,114	411,979
Multi-family	509,673	522,281
Home equity	27,442	29,207
Construction and land	13,678	17,081
Commercial real estate	95,504	94,771
Consumer	268	200
Commercial loans	21,079	19,471
	\$1,064,758	1,094,990

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The Company provides several types of loans to its customers, including residential, construction, commercial and consumer loans. Significant loan concentrations are considered to exist for a financial institution when there are amounts loaned to one borrower or to multiple borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. While credit risks are geographically concentrated in the Company's Milwaukee metropolitan area, there are no concentrations with individual or groups of related borrowers. While the real estate collateralizing these loans is residential in nature, it ranges from owner-occupied single family homes to large apartment complexes.

Qualifying loans receivable totaling \$855.7 million and \$844.2 million at March 31, 2015 and December 31, 2014, respectively, are pledged as collateral against \$350.0 million in outstanding Federal Home Loan Bank of Chicago advances under a blanket security agreement.

As of March 31, 2015 and December 31, 2014, there are no loans that are 90 or more days past due and still accruing interest.

An analysis of past due loans receivable as of March 31, 2015 and December 31, 2014 follows:

As of March 31,	
2015	
1-59-89	
Days	Days
Past	Past
Due	90 Days
(1) (2)	or
	Greater