

Oconee Federal Financial Corp.  
Form 10-K  
September 28, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K

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

For the Fiscal Year Ended June 30, 2016  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 001-35033  
Oconee Federal Financial Corp.  
(Exact Name of Registrant as Specified in its Charter)  
Federal 32-0330122  
(State or Other Jurisdiction of  
Incorporation or Organization) (I.R.S. Employer  
Identification Number)  
201 East North Second Street, Seneca, South Carolina 29678  
(Address of Principal Executive Offices) (Zip Code)  
(864) 882-2765  
(Registrant's Telephone Number Including Area Code)  
Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered The NASDAQ Stock Market, LLC
Common Stock, par value \$0.01 per share	

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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. 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 the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of September 19, 2016 there were 5,812,690 shares outstanding of the registrant's common stock. The aggregate value of the voting and non-voting common stock held by non-affiliates of the registrant, computed by reference to the closing price of the common stock as of December 31, 2015 was \$22.3 million.

**DOCUMENTS INCORPORATED BY REFERENCE**

1. Portions of the Proxy Statement for the 2016 Annual Meeting of Stockholders. (Part III)
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PART I

ITEM 1. Business

Forward Looking Statements

This annual report contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans and prospects and growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on our current beliefs and expectations 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. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Annual Report.

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:

- our ability to manage our operations in response to changes in economic conditions (including real estate values, loan demand, inflation, commodity prices and employment levels) nationally and in our market areas;
- adverse changes in the financial industry, securities, credit and national and local real estate markets (including real estate values);
- significant increases in our delinquencies and loan losses, including as a result of our inability to resolve classified assets, changes in the underlying cash flows of our borrowers, and management's assumptions in determining the adequacy of the allowance for loan losses;
- credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and in our allowance and provision for loan losses;
- use of estimates for determining the fair value of certain of our assets, which may prove to be incorrect and result in significant declines in valuations;
- increased competition among depository and other financial institutions;
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our ability to attract and maintain deposits, including by introducing new deposit products;

- changes in interest rates generally, including changes in the relative differences between short term and long term interest rates and in deposit interest rates, that may affect our net interest margin and funding sources;
- fluctuations in the demand for loans, which may be affected by the number of unsold homes, land and other properties in our market areas and by declines in the value of real estate in our market area;
- declines in the yield on our assets resulting from the current low interest rate environment;
- our ability to successfully implement our business strategies;
- risks related to a high concentration of loans secured by real estate located in our market areas;
- changes in the level of government support of housing finance;

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- the results of examinations by our regulators, including the possibility that our regulators may, among other things, require us to increase our allowance for loan losses, write down assets, change our regulatory capital position, limit our ability to borrow funds or maintain or increase deposits, or prohibit us from paying dividends, which could adversely affect our dividends and earnings;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- changes in laws or government regulations or policies affecting financial institutions, which could result in, among other things, increased deposit insurance premiums and assessments, capital requirements, regulatory fees and compliance costs and the resources we have available to address such changes;
- technological changes that may be more difficult or expensive than expected;
- our reliance on a small executive staff;
- changes in our compensation and benefit plans, and our ability to retain key members of our senior management team and to address staffing needs to implement our strategic plan;
- 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 and the Public Company Accounting Oversight Board;
- our ability to control costs and expenses, particularly those related to operating as a publicly traded company;
- other changes in our financial condition or results of operations that reduce capital available to pay dividends;
- other changes in the financial condition or future prospects of issuers of securities that we own, including our stock in the Federal Home Loan Bank (“FHLB”) of Atlanta; and
- other economic, competitive, governmental, regulatory and operational factors affecting our operations, pricing, products and services.

Oconee Federal Financial Corp.

Oconee Federal Financial Corp. (the “Company”) is a federally-chartered corporation that was incorporated in January 2011 to be the mid-tier stock holding company for Oconee Federal Savings and Loan Association in connection with the mutual holding company reorganization of Oconee Federal Savings and Loan Association.

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As of June 30, 2016, Oconee Federal Financial Corp. had 5,837,908 shares outstanding and a market capitalization of approximately \$114.2 million.

The executive offices of Oconee Federal Financial Corp. are located at 201 East North Second Street, Seneca, South Carolina 29678, and the telephone number is (864) 882-2765. Our website address is [www.oconeefederal.com](http://www.oconeefederal.com).

Information on our website should not be considered a part of this annual report. Oconee Federal Financial Corp. is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System. At June 30, 2016, we had total assets of \$485.6 million, total deposits of \$399.6 million and total equity of \$85.4 million. We recorded net income of \$5.2 million for the year ended June 30, 2016.

Oconee Federal Savings and Loan Association

Oconee Federal Savings and Loan Association is a federally chartered savings and loan association headquartered in Seneca, South Carolina. Oconee Federal Savings and Loan Association was originally chartered by the State of South Carolina in 1924 and in 1991 it converted to a federal charter.

Our principal business consists of attracting retail deposits from the general public in our market area and investing those deposits, together with funds generated from operations, in one-to-four family residential mortgage loans and, to a lesser extent, nonresidential mortgage, construction and land,

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agricultural and other loans. We also invest in U.S. Government and federal agency securities, mortgage-backed securities and short-term deposits. We have also used borrowed funds as a source of funds, and we borrow principally from the Federal Home Loan Bank of Atlanta. We conduct our business from our executive office and seven branch offices. Our offices are located in Oconee County, South Carolina, Stephens County, Georgia and Rabun County, Georgia. Our primary market area consists of the counties where we have offices and the nearby communities and townships in adjacent counties in South Carolina and Georgia.

Oconee Federal Savings and Loan Association is subject to comprehensive regulation and examination by the Office of the Comptroller of the Currency. Oconee Federal Savings and Loan Association is a member of the Federal Home Loan Bank system.

**Oconee Federal, MHC**

Oconee Federal, MHC is a federally-chartered mutual holding company formed in January 2011 to become the mutual holding company of Oconee Federal Financial Corp. in connection with the mutual holding company reorganization of Oconee Federal Savings and Loan Association. As a mutual non-stock holding company, Oconee Federal, MHC has as its members all holders of deposit accounts at, and certain borrowers of, Oconee Federal Savings and Loan Association as of October 21, 1991. As a mutual holding company, Oconee Federal, MHC is required by law to own a majority of the voting stock of Oconee Federal Financial Corp. Oconee Federal, MHC is not currently, and at no time has been, an operating company.

**Acquisition**

On December 1, 2014, the Company and Oconee Federal, MHC completed the acquisition of Stephens Federal Bank (“Stephens Federal”). The acquisition was consummated in accordance with the Agreement and Plan of Merger by and among the Company, Oconee Federal MHC, Oconee Federal Savings and Loan Association and Stephens Federal dated February 26, 2014, as amended on May 6, 2014 (the “Merger Agreement”), pursuant to which Stephens Federal merged with and into the Oconee Federal Savings and Loan Association, with the Oconee Federal Savings and Loan Association as the surviving institution.

Pursuant to the terms of the Merger Agreement, Stephens Federal completed a voluntary supervisory conversion from a federally chartered mutual savings association to a federally chartered stock savings association immediately prior to the merger with Oconee Federal Savings and Loan Association. Accordingly, no consideration was paid by Oconee Federal Savings and Loan Association or the Company in connection with the acquisition of Stephens Federal; however, upon completion of the acquisition, the Company issued 36,945 shares of Company common stock to Oconee Federal, MHC, which is equal to the quotient of (i) the valuation of Stephens Federal, which was \$700, as determined by an independent third party, divided by (ii) the average closing price of the Company’s common stock as reported on the NASDAQ for the 20 consecutive trading days ending on the third trading day preceding the effective date of the acquisition, or approximately \$18.95 per share, rounded.

The acquisition expanded our market area to northeast Georgia, specifically Stephens and Rabun Counties, where we added three additional branches, two in Toccoa, Georgia of Stephens County and one in Clayton, Georgia of Rabun County. These counties and surrounding counties and townships have enhanced our ability to build our deposit base and opened up new lending markets to us. We also acquired a secondary mortgage lending platform with Freddie Mac through the acquisition that has opened new opportunities for us to reach customers with new mortgage products that we were not able to offer before.

As a result of the acquisition, we added \$140.9 million in total assets at fair value, which included goodwill of \$2.6 million and deferred tax assets of \$5.1 million.

**Market Area**

We conduct business through our executive office and four branches in the towns of Seneca, Walhalla, and Westminster South Carolina, and three branches in the towns of Toccoa and Clayton, Georgia. All five of our South Carolina offices are located in Oconee County, which is located on the I-85 corridor between the Charlotte and Atlanta metropolitan areas, approximately 120 miles south of Charlotte and

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approximately 120 miles north of Atlanta. Our South Carolina offices are also located approximately 40 miles south of Greenville, South Carolina, and 10 miles from Clemson, South Carolina. Two of our Georgia branches are located in Stephens County and one is located in Rabun County. Both counties border Oconee County, South Carolina. Our primary market area, which consists of Oconee County, South Carolina and Stephens and Rabun Counties, Georgia and their nearby communities and townships in adjacent counties in both South Carolina and Georgia, is mostly rural and suburban in nature. The regional economy is fairly diversified, with services, wholesale/retail trade, manufacturing and government representing the primary industries. In addition, Oconee County and nearby counties are experiencing an increase in retiree populations. Oconee County's and South Carolina's respective June 2016 unemployment rates of 5.8% and 5.4%. Rabun County and Stephens County had 5.6% and 6.0% June 2016 unemployment rates, respectively, and Georgia's overall rate was 5.1%. The national unemployment rate was 4.9% for June 2016.

The largest employers in our market area are education and health services providers; public utilities and light manufacturing companies; including the city and county school systems; Oconee Memorial Hospital; Duke Energy, an electric utility and provider of nuclear and hydroelectric energy; Schneider Electric-Square D, a manufacturer of electronic components; Itron, a manufacturer of electronic measuring devices; and BorgWarner, a supplier of motor vehicle parts and systems. Other employers include the local government, retail trade and the leisure/hospitality industry. Many residents of Oconee County are employed in nearby Greenville, South Carolina, which has major employers such as BMW Motors, Inc. and Greenville Health System, and in Pickens County, which has major employers such as Clemson University and the Pickens County school system.

Competition

Competition for making loans and attracting deposits in our primary market area is intense, particularly in light of the relatively modest population base of our primary markets and the relatively large number of institutions that maintain a presence in the area. Financial institution competitors in our primary market area include other locally-based commercial banks, thrifts and credit unions, as well as regional and super-regional banks. We also compete with depository and lending institutions not physically located in our primary market area but capable of doing business remotely, mortgage loan originators and mortgage brokers and other companies in the financial services industry, such as investment firms, mutual funds and insurance companies. Some of our competitors offer products and services that we currently do not offer, such as investment services, trust services and private banking. To meet our competition, we seek to emphasize our community orientation, local and timely decision making and superior customer service. As of June 30, 2015 the most recent date of available data, our market share of deposits represented 24.1%, 30.0%, and 9.8% of FDIC-insured deposits in Oconee County, SC, Stephens County, GA, and Rabun County, GA, respectively.

Lending Activities

The principal lending activity of Oconee Federal Savings and Loan Association is originating one-to-four family residential mortgage loans and, to a lesser extent, home equity loans and lines of credit, nonresidential real estate loans, construction and land loans, commercial loans, agricultural loans, and other loans. We increased our loan portfolio of nonresidential real estate loans, home equity loans and lines of credit, and added agricultural loans and to a much lesser extent than the other segments, commercial and industrial loans through the acquisition of Stephens Federal. We plan to continue to maintain the loans we acquired that are of sound credit quality in our portfolio and to increase our lending in nonresidential real estate loans to a modest extent in our primary market area.

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Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio by type of loan at the dates indicated:

	At June 30,		2015		2014	
	2016		Amount	Percent	Amount	Percent
	Amount	Percent				
	(Dollars in thousands)					
Real estate loans:						
One-to-four family	\$ 242,067	82.56%	\$ 256,321	82.57%	\$ 214,735	92.55%
Multi-family	1,996	0.68	2,574	0.83	254	0.11
Home equity	6,433	2.19	8,198	2.64	227	0.10
Nonresidential	20,310	6.93	21,685	6.98	8,408	3.62
Agricultural	2,958	1.01	4,164	1.34	—	0.00
Construction and land	14,332	4.89	14,590	4.70	7,661	3.30
Total real estate loans	288,096	98.26	307,532	99.06	231,285	99.68
Commercial and industrial	176	0.06	184	0.06	—	0.00
Consumer and other loans	4,915	1.68	2,745	0.88	747	0.32
Total loans	\$ 293,187	100.00%	\$ 310,461	100.00%	\$ 232,032	100.00%
Net deferred loan fees	(1,124)		(1,194)		(1,246)	
Allowance for loan losses	(922)		(1,008)		(855)	
Loans, net	\$ 291,141		\$ 308,259		\$ 229,931	
	At June 30,		2012			
	2013		Amount	Percent		
	Amount	Percent				
	(Dollars in thousands)					
Real estate loans:						
One-to-four family	\$ 204,397	91.61%	\$ 234,125	92.82%		
Multi-family	258	0.12	264	0.10		
Home equity	292	0.13	395	0.16		
Nonresidential	8,521	3.82	9,226	3.66		
Construction and land	8,735	3.91	7,232	2.87		
Total real estate loans	222,203	99.59	251,242	99.61		
Consumer and other loans	925	0.41	987	0.39		
Total loans	\$ 223,128	100.00%	\$ 252,229	100.00%		
Net deferred loan fees	(1,214)		(1,540)			
Allowance for loan losses	(751)		(857)			
Loans, net	\$ 221,163		\$ 249,832			

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Contractual Maturities and Interest Rate Sensitivity. The following table summarizes the scheduled repayments of our loan portfolio at June 30, 2016. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less. Loans are presented net of loans in process.

Real Estate Loans									
	One-to-Four Family	Multi-family	Home Equity	Nonresidential	Agricultural	Construction and Land	Commercial and Industrial	Consumer and Other	Total
(Dollars in thousands)									
Amounts due in:									
One year or less	\$ 1,710	\$ —	\$ 1,455	\$ 856	\$ —	\$ 805	\$ 125	\$ 4,261	\$ 9,212
More than one to two years	1,672	—	1,661	20	39	202	51	264	3,909
More than two to three years	2,218	—	1,942	66	352	320	—	59	4,957
More than three to five years	4,948	116	262	1,691	70	997	—	74	8,158
More than five to ten years	26,890	171	945	7,709	939	5,969	—	131	42,754
More than ten to fifteen years	18,420	633	81	5,107	827	407	—	—	25,475
More than fifteen years	186,209	1,076	87	4,861	731	5,632	—	126	198,722
Total	\$ 242,067	\$ 1,996	\$ 6,433	\$ 20,310	\$ 2,958	\$ 14,332	\$ 176	\$ 4,915	\$ 293,187

The following table summarizes our fixed-rate and adjustable-rate loans that are due after June 30, 2017:

Real Estate Loans									
	One-to-Four Family	Multi-family	Home Equity	Nonresidential	Agricultural	Construction and Land	Commercial and Industrial	Consumer and Other	Total
(Dollars in thousands)									

Interest rate  
terms on  
amounts due  
after one year:

Fixed-rate loans	\$ 216,896	\$ 665	\$ 3,193	\$ 13,095	\$ 1,758	\$ 12,962	\$ 51	\$ 654	\$ 249,271
Adjustable-rate loans	23,461	1,331	1,785	6,359	1,200	565	—	—	34,701
Total	\$ 240,357	\$ 1,996	\$ 4,978	\$ 19,454	\$ 2,958	\$ 13,527	\$ 51	\$ 654	\$ 283,972

Loan Approval Procedures and Authority. Pursuant to federal law, the aggregate amount of loans that Oconee Federal Savings and Loan Association is permitted to make to any one borrower or a group of related borrowers is generally limited to 15% of Oconee Federal Savings and Loan Association's unimpaired capital and surplus (25% if the amount in excess of 15% is secured by "readily marketable collateral" or 30% for certain residential development loans). At June 30, 2016, based on the 15% limitation, Oconee Federal Savings and Loan Association's loans-to-one-borrower limit was approximately \$12.8 million. At June 30, 2016, our largest loan relationship with one borrower was for approximately \$3.5 million secured by a brokerage account and was performing in accordance with its terms on that date.

Our lending is subject to written underwriting standards and origination procedures. Decisions on loan applications are made on the basis of detailed applications submitted by the prospective borrower, credit histories that we obtain, and property valuations (consistent with our appraisal policy) prepared by outside independent licensed appraisers approved by our board of directors as well as internal evaluations, where permitted by regulations. The loan applications are designed primarily to determine the borrower's ability to repay the requested loan, and the more significant items on the application are verified through use of credit reports, financial statements and tax returns. Under our loan policy, the loan officer processing an application is responsible for ensuring proposals and approval of any extensions of credit are in compliance with internal policies and procedures and applicable laws and regulations, and for establishing and maintaining credit files and documentation sufficient to support the loan and to perfect any collateral position.

Our lending officers do not have individual lending authority. Two members of the Management Credit Committee must jointly approve all portfolio loan applications where the total credit exposure would be up to \$500 thousand. Total credit exposure is the sum total of all loans that a customer has directly or guarantees with Oconee Federal. Three members of the Management Credit Committee must jointly approve all portfolio loan applications where the total credit exposure would be between \$500 thousand and

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\$1 million. These loan applications would be reviewed regularly by the Board Credit Committee. The Board of Directors approves all portfolio loan applications where the total credit exposure exceeds \$1 million. To ensure adequate liquidity, under our loan policy, aggregate loans outstanding should not exceed our total deposits and advances from the Federal Home Loan Bank of Atlanta.

Generally, we require title insurance or abstracts on our mortgage loans as well as fire and extended coverage casualty insurance in amounts at least equal to the principal amount of the loan or the value of improvements on the property, depending on the type of loan.

One-to-four Family Residential Real Estate. The cornerstone of our lending program has long been the origination of long-term loans secured by mortgages on owner-occupied one-to-four family residences. At June 30, 2016, \$242.1 million, or 82.6% of our total loan portfolio, consisted of one-to-four family residential mortgage loans. At that date, our average outstanding one-to-four family residential mortgage loan balance was \$120 thousand and our largest outstanding residential loan had a principal balance of \$1.7 million. At June 30, 2016, our ten largest one-to-four family residential loans in our portfolio totaled \$12.3 million. Virtually all of the residential mortgage loans we originate are secured by properties located in our market area.

The repayment terms of our mortgage loans are generally up to 30 years for traditional homes and up to 15 years for manufactured or modular homes. The repayment terms of non-owner-occupied homes are generally up to 15 years for fixed-rate loans and up to 30 years for adjustable-rate loans. Due to consumer demand in the current low market interest rate environment, many of our recent originations are 15- to 30-year fixed-rate loans secured by one-to-four family residential real estate. Although we typically retain in our portfolio the loans we originate, we generally originate our fixed-rate one-to-four family residential loans in accordance with secondary market standards.

Our adjustable-rate mortgage loans have fixed rates for the first 12 months, and then carry interest rates that adjust annually at a rate based on the change, between closing of the loan and the adjustment date, of the Federal Housing Finance Agency's published contract interest rate, which represents the national average rate for purchases of previously occupied homes. Such loans carry terms to maturity of up to 30 years. The adjustable-rate mortgage loans currently offered by us generally provide for a 100 basis point annual interest rate change cap, a lifetime cap of 500 basis points over the initial rate and a lifetime floor of 200 basis points under the initial rate.

Although adjustable-rate mortgage loans may reduce our vulnerability to changes in market interest rates because they periodically reprice, as interest rates increase, the required payments due from the borrower also increase (subject to rate caps), 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 adjustments of the contractual interest rate are also limited by the maximum periodic and lifetime rate adjustments permitted by our loan documents. At June 30, 2016, \$23.5 million, or 9.7% of our one-to-four family residential loans, had adjustable rates of interest. No adjustable-rate one-to-four family residential loans were originated during the year ended June 30, 2016.

We evaluate both the borrower's ability to make principal, interest and escrow payments and the value of the property that will secure the loan. Our one-to-four family residential mortgage loans do not currently include prepayment penalties and do not produce negative amortization. Our one-to-four family residential mortgage loans customarily include due-on-sale clauses giving us the right to declare the loan immediately due and payable in the event that, among other things, the borrower sells the property subject to the mortgage.

We currently originate residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes. For traditional homes, we may originate loans with loan-to-value ratios in excess of 80% if the borrower obtains mortgage insurance or provides readily marketable collateral. We may make exceptions for special loan programs that we offer. For example, we currently offer mortgages of up to \$95 thousand with loan-to-value ratios of up to 95% to low- to moderate-income borrowers solely for the purchase of their primary residence. We also originate residential mortgage loans for non-owner-occupied homes with loan-to-value ratios of up to 80%.

At June 30, 2016, we had \$1.9 million of one-to-four family residential mortgage loans that were 60 days or more delinquent and \$7.1 million of one-to four-family residential mortgage loans that were 30-59

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days delinquent. Among delinquent loans past due more than 60 days, two loans exceeded \$200 thousand in outstanding principal, or 23.9%, of total loans in this category. For loans 30-59 days past due, four loans with outstanding balances greater than \$250 thousand totaled \$1.3 million, or 18.7%, of the total balance of loans in this category.

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

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

At June 30, 2016, multi-family real estate loans totaled \$2.0 million or 0.7% of the loan portfolio. All of these loans were performing in accordance with their terms at June 30, 2016.

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

At June 30, 2016, we had \$6.4 million of home equity loans and lines of credit outstanding, representing 2.2% of our total loan portfolio. We had \$106 thousand of home equity loans that were 60 days or more delinquent and \$94 thousand of home equity loans that were 30-59 days delinquent at June 30, 2016.

**Nonresidential Real Estate.** Nonresidential loans include those secured by real estate mortgages on churches, owner-occupied and non-owner occupied commercial buildings of various types, retail and office buildings, hotels, and other business and industrial properties. The nonresidential real estate loans that we originate generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of our nonresidential real estate loans is generally 75%. At June 30, 2016, we had \$20.3 million in nonresidential real estate loans, representing 6.9% of our total loan portfolio. At June 30, 2016, our average outstanding nonresidential mortgage loan balance was \$257 thousand. Our largest nonresidential real estate relationship totaled \$2.4 million, all of which was related to one loan. This loan is secured by a mortgage on a church building in Oconee County, and, at June 30, 2016, this loan was performing in accordance with its terms. At June 30, 2016, of our ten largest loans in our total portfolio, three loans totaling \$5.2 million were nonresidential real estate loans.

Set forth below is information regarding our nonresidential real estate loans at June 30, 2016:

Type of Loan	Number of Loans	Balance (Dollars in thousands)
Church	22	\$ 9,357
Office buildings	22	4,050
Other nonresidential	35	6,903

Total 79\$ 20,310

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

Loans secured by nonresidential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Nonresidential real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. In addition, because a church's financial stability often depends on donations from congregation members, some of whom may not reside in our market area, rather than income from business operations, repayment may be affected by economic conditions that affect individuals located both in our market area and in other market areas with which we are not as familiar. In addition, due to the unique nature of church buildings and properties, the real estate securing church loans may be less marketable than other nonresidential real estate. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate. At June 30, 2016, we had \$990 thousand of nonresidential real estate loans that were 60 days or more delinquent. No nonresidential real estate loans were 30-59 days delinquent. Among delinquent loans past due 60 days or more, two loans exceeded \$350 thousand in outstanding principal.

**Agricultural.** As a result of the Stephens Federal acquisition, the Company acquired agricultural real estate loans. These loans are secured by farmland and related improvements in the Company's market area. These loans generally have terms of five to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of these loans is generally 75%. The Company is managing a small number of these loans in our portfolio.

Loans secured by agricultural real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Agricultural real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. At June 30, 2016, we had \$2.9 million of agricultural loans outstanding, representing 1.0% of our total loan portfolio. At June 30, 2016, our average outstanding agricultural loan balance was \$246 thousand. Our largest agricultural relationship totaled \$977 thousand, of which \$938 thousand was related to one loan. This loan is secured by a mortgage on a farm in Stephens County, and, at June 30, 2016, this loan was performing in accordance with its terms. At June 30, 2016, all of our agricultural loans were performing in accordance with their terms.

**Construction and Land.** We generally make construction loans to individuals for the construction of their primary residences and to commercial businesses for their real estate needs. These loans generally have maximum terms of twelve months, and upon completion of construction convert to conventional amortizing mortgage loans. Residential construction loans have rates and terms comparable to one-to-four family residential mortgage loans that we originate. Commercial construction loans have rates and terms comparable to other commercial real estate loans that we originate. During the construction phase, the borrower generally pays interest only. The maximum loan-to-value ratio of our owner-occupied

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construction loans is 80%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential mortgage loans. Commercial construction loans are generally underwritten pursuant to the same guidelines used for originating other commercial real estate loans.

We make loans secured by land to complement our construction lending activities. These loans have terms of up to 10 years, and maximum loan-to-value ratios of 75% for improved lots and 65% for unimproved land. At June 30, 2016, we had \$14.3 million of construction and land loans outstanding, representing 4.9% of our total loan portfolio.

	Number of Loans	Loans in Process	Net Principal Balance
(Dollars in thousands)			
One-to-four family	41	\$ 9,456	\$ 7,210
Residential land	112	—	6,180
Nonresidential	5	—	942
Total construction and land loans	158	\$ 9,456	\$ 14,332

At June 30, 2016, our largest residential construction loan was for \$2.0 million, of which \$1.2 million was outstanding. This loan was performing according to its terms at June 30, 2016. At June 30, 2016, we had \$93 thousand of our residential land loans that were 30-59 days delinquent and \$25 thousand that were 60 days or more delinquent. The application process for a construction loan includes a submission to Oconee Federal Savings and Loan Association of accurate plans, specifications and costs of the project to be constructed or developed, a copy of the deed or plat survey of the real estate involved in the loan and an appraisal of the proposed collateral for the loan. Our construction loan agreements generally provide that loan proceeds are disbursed in increments as construction progresses. Outside independent licensed or certified appraisers or architects inspect the progress of the construction of the dwelling before disbursements are made.

To the extent our construction loans are not made to owner-occupants of single-family homes, they are more vulnerable to changes in economic conditions and the concentration of credit with a limited number of borrowers. Further, the nature of these loans is such that they are more difficult to evaluate and monitor. Our risk of loss on a construction or land loan is dependent largely upon the accuracy of the initial estimate of the property's value upon completion of the project and the estimated cost (including interest) of the project. If the estimate of value proves to be inaccurate, we may be confronted, at or prior to the maturity of the loan, with a project with a value which is insufficient to assure full repayment and/or the possibility of having to make substantial investments to complete and sell the project. Because defaults in repayment may not occur during the construction period, it may be difficult to identify problem loans at an early stage.

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

Commercial and industrial loans and leases typically are underwritten on the basis of the borrower's or lessee's ability to make repayment from the cash flow of its business and generally are collateralized by business assets. As a result, such loans and leases involve additional complexities, variables and risks and require more thorough underwriting and servicing than other types of loans and leases. At June 30, 2016, we had \$176 thousand of commercial and industrial loans outstanding, representing 0.1% of our total loan portfolio. At June 30, 2016, all of our commercial and industrial loans were performing in accordance with their terms.

**Consumer.** We offer installment loans for various consumer purposes, including the purchase of automobiles, boats, and for other legitimate personal purposes. The maximum terms of consumer loans is 18 months for unsecured loans, 12 months for loans secured by marketable securities and 18 to 60 months



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for loans secured by a vehicle, depending on the age of the vehicle. The Company generally only extends consumer loans to existing customers or their immediate family members, and these loans generally have relatively low balances.

To date, our consumer lending, apart from home equity loans, has been quite limited. At June 30, 2016, we had \$4.9 million of consumer loans outstanding, representing 1.7% of our total loan portfolio. Of these loans, \$1.4 million, or 28.6%, were secured by deposits at Oconee Federal Savings and Loan Association.

Consumer loans may entail greater credit risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At June 30, 2016, all of our consumer loans were performing in accordance with their terms.

Originations, Purchases and Sales of Loans

Lending activities are conducted solely by our salaried personnel operating at our main and branch office locations. All loans originated by us are underwritten pursuant to our policies and procedures. We originate both fixed-rate and adjustable-rate loans. Our ability to originate fixed or adjustable-rate loans is dependent upon relative customer demand for such loans, which is affected by current and expected future levels of market interest rates. We originate real estate and other loans through our salaried loan officers, marketing efforts, our customer base, walk-in customers and referrals from real estate brokers, builders and attorneys.

With the exception of loans acquired through the Stephens Federal acquisition, we currently do not purchase whole loans or interests in loans from third parties.

The following table shows our gross loan origination and principal repayment activity for loans originated for our portfolios during the periods indicated:

	Years Ended June 30,	
	2016	2015
	(In thousands)	
Total loans at beginning of period	\$ 310,461	\$ 232,032
Loans originated:		
Real estate loans:		
One-to-four family	15,270	20,505
Multi-family	—	—
Home equity	178	170
Nonresidential	3,738	895
Agricultural	263	974
Construction and land	7,313	5,680
Total real estate loans	26,762	28,224
Commercial and industrial	51	131
Consumer and other loans	4,610	1,584
Total loans originated	31,423	29,939
Loans acquired through Stephens Federal Acquisition:	—	95,462
Deduct:		
Principal repayments	(43,747)	(43,393)
Sold loans that were acquired in Stephens Federal acquisition	(2,587)	(2,809)
Charge-offs	(537)	(42)
Transfers to real estate owned	(1,826)	(728)

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Net loan activity	(17,274)	78,429
Total loans at end of period	\$ 293,187	\$ 310,461

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We added the capabilities and access to the Freddie Mac secondary mortgage lending program through the acquisition of Stephens Federal. As such we originated \$4.3 million and sold \$4.6 million of conforming one-to-four residential real estate mortgage loans for the year ended June 30, 2016.

**Delinquencies and Nonperforming Assets**

**Delinquency Procedures.** It is the policy of the Association to promptly identify all delinquent loan accounts and use all reasonable and legal means either to cure the delinquencies or to take prompt legal action to foreclose, repossess or liquidate the collateral.

When we acquire real estate as a result of foreclosure, the real estate is classified as real estate owned. Real estate owned is initially recorded at fair value less costs to sell. Thereafter, it is recorded at the lower of carrying amount or fair value, less estimated costs to sell. Soon after acquisition, we order a new appraisal to determine the current market value of the property. Any excess of the recorded value of the loan satisfied over the market value of the property is charged against the allowance for loan losses, or, if the existing allowance is inadequate, charged to expense of the current period. After acquisition, all costs incurred in maintaining the property are expensed. Costs relating to the development and improvement of the property, however, are capitalized to the extent of estimated fair value less estimated costs to sell. Subsequent impairments in value of real estate owned are recorded as an impairment loss.

**Delinquent Loans.** The following table sets forth our loan delinquencies by type and amount at the dates indicated:

	At June 30, 2016				2015			
	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due
	(Dollars in thousands)							
Real estate loans:								
One-to-four family	\$ 7,086	\$ 1,001	\$ 863	\$ 8,950	\$ 5,871	\$ 1,243	\$ 2,311	\$ 9,425
Multi-family	—	—	—	—	—	—	—	—
Home equity	94	22	84	200	49	—	—	49
Nonresidential	—	48	942	990	229	313	1,108	1,650
Agricultural	—	—	—	—	—	—	—	—
Construction and land	93	—	25	118	78	—	—	78
Total real estate loans	7,273	1,071	1,914	10,258	6,227	1,556	3,419	11,202
Commercial and industrial	—	—	—	—	—	—	—	—
Consumer and other loans	—	—	—	—	1	1	—	2
Total	\$ 7,273	\$ 1,071	\$ 1,914	\$ 10,258	\$ 6,228	\$ 1,557	\$ 3,419	\$ 11,204

Total delinquencies decreased \$946 thousand, or 8.4%, to \$10.3 million at June 30, 2016 as compared to total delinquencies of \$11.2 million at June 30, 2015. At June 30, 2016, \$3.9 million of loans past due were acquired loans, with \$1.3 million past due 90 days or more. Of the total past due acquired loans, \$1.4 million were loans that at the date of acquisition had evidence of credit deterioration that according to generally accepted accounting principles are defined as “purchased credit impaired loans.” There were \$988 thousand of purchased credit impaired loans that were 90

or more days past due at June 30, 2016. Total delinquencies among our originated loans was \$6.4 million, with \$627 thousand 90 days or more past due. We count loans with partial payments due as delinquent.

**Classified Assets.** Federal regulations provide for the classification of loans and other assets, such as debt and equity securities considered to be of lesser quality, as “substandard,” “doubtful” or “loss.” An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any.

“Substandard” assets include those characterized by the “distinct possibility” that the insured institution will sustain “some loss” if the deficiencies are not

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corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard,” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss allowance is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated as “special mention” by our management.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances in an amount deemed prudent by management to cover probable accrued losses. General allowances represent loss allowances which have been established to cover probable accrued losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as “loss,” it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge-off such amount. An institution’s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the regulatory authorities, which may require the establishment of additional general or specific loss allowances.

In connection with the filing of our periodic reports to our regulators and in accordance with our classification of assets policy, we regularly review the problem loans in our portfolio to determine whether any loans require classification in accordance with applicable regulations.

On the basis of this review of our assets, our classified or special mention assets at the dates indicated were as set forth below. Special mention and substandard assets are presented gross of allowance, and doubtful assets are presented net of allowance.

	At June 30,	
	2016	2015
	(Dollars in thousands)	
Special mention assets	\$ 4,562	\$ 4,797
Substandard assets	8,208	9,847
Doubtful assets	—	271
Loss assets	—	—
Real estate owned	1,354	2,092
Total classified assets	\$ 14,124	\$ 17,007

Real estate owned assets decreased by \$738 thousand, or 35.3%, to \$1.4 million at June 30, 2016 from \$2.1 million at June 30, 2015. Our doubtful assets decreased from \$271 thousand at June 30, 2015 to \$0 at June 30, 2016 and our substandard assets decreased by \$1.6 million, or 16.6%, to \$8.2 million at June 30, 2016 from \$9.8 million at June 30, 2015. Our overall classified asset totals decreased by \$2.9 million, or 17.0%, to \$14.1 million at June 30, 2016 from \$17.0 million at June 30, 2015. Special mention assets at June 30, 2016 consisted primarily of one-to-four family real estate loans of \$1.9 million, nonresidential real estate loans of \$1.5 million and agricultural loans of \$676 thousand. Substandard assets at June 30, 2016 consisted primarily of \$5.5 million in one-to-four family residential real estate loans and \$1.5 million of nonresidential real estate loans.

Loans classified as substandard and doubtful are considered to be impaired loans. Impaired loans are loans for which we do not reasonably believe that we will collect all contractual principal and interest payments due on the loans. The recorded investment of these loans at June 30, 2016 was \$5.4 million, a decrease of \$4.7 million from \$10.1 million at June 30, 2015. Specific allowances of \$184 thousand and \$220 thousand were reserved for these loans at June 30, 2016 and 2015, respectively.

Nonperforming Assets. We generally cease accruing interest on our loans when contractual payments of principal or interest have become 90 days delinquent unless the loan is well-secured and in the process of collection. Loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful. All



interest accrued but not received for loans placed on nonaccrual are reversed against interest income. Interest received on such loans is accounted for on the cash-basis or

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cost-recovery method, until the loans qualify for return to accrual. Generally, loans are restored to accrual status when all the principal and interest amounts contractually due are brought current, and future payments are reasonably assured. Loans are moved to nonaccrual status in accordance with our policy, which is typically after 90 days of non-payment. Loans for which the terms have been modified and for which (i) the borrower is experiencing financial difficulties and (ii) we have granted a concession to the borrower are considered troubled debt restructurings (“TDRs”) and are included in impaired loans and leases. Income on nonaccrual loans or leases, including impaired loans and leases but excluding certain TDRs which continue to accrue interest, is recognized on a cash basis when and if actually collected. For the year ended June 30, 2016, there were no defaults on any loans that were considered TDRs. At June 30, 2016, all TDRs were on nonaccrual status.

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The table below sets forth the amounts and categories of our nonperforming assets at the dates indicated:

	At June 30,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Nonaccrual loans:					
Real estate loans:					
One-to-four family	\$ 2,133	\$ 2,311	\$ 1,647	\$ 1,493	\$ 2,157
Multi-family	—	—	—	—	—
Home equity	126	—	—	—	—
Nonresidential	942	1,379	—	—	—
Agricultural	531	487	—	—	—
Construction and land	25	—	—	—	—
Total real estate loans	3,757	4,177	1,647	1,493	2,157
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total nonaccrual loans	\$ 3,757	\$ 4,177	\$ 1,647	\$ 1,493	\$ 2,157
Accruing loans past due 90 days or more:					
Real estate loans:					
One-to-four family	\$ —	\$ —	\$ —	\$ 493	\$ 145
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	—	—	—	—	—
Agricultural	—	—	—	—	—
Construction and land	—	—	—	—	—
Total real estate loans	—	—	—	493	145
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total accruing loans past due 90 days or more	—	—	—	493	145
Total of nonaccrual and 90 days or more past due loans	\$ 3,757	\$ 4,177	\$ 1,647	\$ 1,986	\$ 2,302
Real estate owned:					
One-to-four family	\$ 899	\$ 1,335	\$ 744	\$ 1,047	\$ 854
Multi-family	—	—	—	—	—
Home equity	267	—	—	—	—
Nonresidential	188	365	—	—	—
Construction and land	—	392	—	—	—
Total real estate owned	1,354	2,092	744	1,047	854
Other nonperforming assets	—	—	—	—	—
Total nonperforming assets	\$ 5,111	\$ 6,269	\$ 2,391	\$ 3,033	\$ 3,156
Troubled debt restructurings	\$ —	\$ —	\$ —	\$ —	\$ —
	\$ 5,111	\$ 6,269	\$ 2,391	\$ 3,033	\$ 3,156

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Troubled debt restructurings and total  
nonperforming assets

Total nonperforming loans to total loans	1.28%	1.35%	0.71%	0.89%	0.91%
Total nonperforming assets to total assets	1.05%	1.32%	0.66%	0.82%	0.84%
Total nonperforming assets to loans and real estate owned	1.73%	2.01%	1.03%	1.35%	1.25%

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All nonperforming loans in the table above were classified either as substandard or doubtful. There were no other loans that are not already disclosed where there is information about possible credit problems of borrowers that caused us serious doubts about the ability of the borrowers to comply with present loan repayment terms and that may result in disclosure of such loans in the future.

Interest income that would have been recorded had our nonaccrual loans been current in accordance with their original terms was \$109 thousand for the year ended June 30, 2016. Interest of \$46 thousand was recognized on these loans and is included in net income for the year ended June 30, 2016. Interest income that would have been recorded had our trouble debt restructured loans been current in accordance with their original terms was \$130 thousand for the year ended June 30, 2016. Interest recognized on trouble debt restructured loans during the year ended June 30, 2016 totaled \$37 thousand.

### Allowance for Loan Losses

**Analysis and Determination of the Allowance for Loan Losses.** Our allowance for loan losses is the amount considered necessary to reflect probable losses inherent in our loan portfolio. We evaluate the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of two key elements: (a) specific allowances for identified problem loans; and (b) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio.

**Specific Allowances for Identified Problem Loans.** We establish a specific allowance when loans are determined to be impaired. Loss is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. Factors in identifying a specific problem loan include:

- the strength of the customer's personal or business cash flows;
- the availability of other sources of repayment;
- the amount due or past due;
- the type and value of collateral;
- the strength of our collateral position;
- the estimated cost to sell the collateral; and
- the borrower's effort to cure the delinquency.

In addition, for loans secured by real estate, we consider the extent of any past due and unpaid property taxes applicable to the property serving as collateral on the mortgage.

**General Valuation Allowance of the Loan Portfolio.** We establish a general allowance for smaller balance, homogenous loans that are not otherwise specifically impaired to recognize the probable incurred losses within our portfolio, but which, unlike specific allowances, has not been allocated to particular problem loans. In estimating this portion of the allowance, we apply loss factors to each loan portfolio segment. Loans not identified as impaired are

aggregated into homogenous pools of loans, or segments, which share similar risk characteristics, primarily based on the type of loan, the purpose of the loan, and the underlying collateral supporting the loan. We estimate our loss factors taking into consideration both quantitative and qualitative aspects that would affect our estimation of probable incurred losses. These aspects include, but are not limited to historical charge-offs; loan delinquencies and foreclosure trends; current economic trends and demographic data within our primary market area such as unemployment rates and population trends; current trends in real estate values within our market area; charge-off trends of other comparable institutions; the results of any internal loan reviews; loan to value ratios; our historically conservative credit risk policy; the strength of our underwriting and ongoing credit monitoring function; and other relevant factors.

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We evaluate our loss factors quarterly to ensure their relevance in the current real estate and economic environment, and we review the allowance for loan losses (as a percentage of total loans) maintained by us relative to other thrift institutions within our peer group, taking into consideration the other institutions' delinquency trends, charge-offs, nonperforming loans, and portfolio composition as a basis for validation for the adequacy of our overall allowance for loan loss.

**Acquired Loans.** We separate loans that we have acquired through a business combination from loans that we have originated when computing the general valuation allowance. We do this as loans that we have acquired have a completely different risk profile as these loans were originated from a different demographic market from ours and underwritten and collateralized according to different lending policies and practices. Therefore, we apply different loss factors to those loans in determining the general valuation allowance. These loss factors represent the credit discounts used in the original fair value determinations made on the date of acquisition of these loans. We will continue to evaluate these factors on a quarterly basis based on both quantitative and qualitative considerations and revise these factors as necessary.

Purchased credit impaired loans are evaluated on a quarterly basis. All purchased credit impaired loans remain identified as purchased credit impaired loans for their remaining lives, even if modified, extended or renewed with the exception of loans that are considered TDR. We perform the same type of evaluation for these loans as any other loan that we believe to be impaired. Each loan acquired that was purchased credit impaired is evaluated on an individual basis. We estimate, based on an evaluation of each loan's credit and collateral, the amount and timing of future cash flows that we expect to receive and discount these cash flows using a risk adjusted rate. If the present value of the future cash flows is less than the current carrying value of the loan, we record a specific valuation allowance against that loan. Each quarter, we perform this process and adjust the allowance for each loan accordingly.

Our allowance at June 30, 2016 reflects both a general valuation component of \$738 thousand and a specific component of \$184 thousand for loans determined to be impaired. In comparison, our allowance at June 30, 2015 consisted of a general valuation component of \$788 thousand and a specific component of \$220 thousand. The overall allowance decreased \$86 thousand and remained stable as a percentage of total loans at 0.31% and 0.32% for the years ended June 30, 2016 and 2015, respectively. Impaired loans decreased from \$10.1 million to \$5.4 million from June 30, 2015 to June 30, 2016 as a result of our efforts to continue liquidating acquired problem loans. At June 30, 2016, all impaired loans were within our acquired loan portfolio and totaled \$5.4 million, \$4.4 million of which were purchased credit impaired. The remaining \$1.0 million of impaired loans were identified as having evidence of credit deterioration not existing at the acquisition date. The amount of impairment measured on these loans was \$184 thousand. Within our originated portfolio, there were no loans identified as impaired at June 30, 2016. At June 30, 2015, within our acquired loan portfolio, we had a total of \$7.9 million in impaired loans, \$7.4 million of which were purchased credit impaired. The remaining \$546 thousand of impaired loans were identified as having evidence of credit deterioration not existing at the acquisition date. The amount of impairment measured on these loans was \$89 thousand. Within our originated portfolio, we had \$2.1 million in impaired loans, and the impairment amount on these loans was \$116 thousand. To the best of our knowledge, we have recorded all losses that are both probable and reasonably estimable for the years ended June 30, 2016 and 2015. Net charge-offs for the year ended June 30, 2016 were \$537 thousand compared to \$42 thousand for the year ended June 30, 2015.

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Allowance for Loan Losses. The following table sets forth activity in our allowance for loan losses for the periods indicated:

	Year Ended June 30,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Allowance at beginning of period	\$ 1,008	\$ 855	\$ 751	\$ 857	\$ 749
Provision for loan losses	451	195	108	260	270
Charge-offs:					
Real estate loans					
One-to-four family	(447)	—	(4)	(366)	(145)
Multi-family	—	—	—	—	—
Home equity	(72)	(40)	—	—	—
Nonresidential	—	—	—	—	—
Agricultural	—	—	—	—	—
Construction and land	(9)	—	—	—	(17)
Commercial and industrial	—	—	—	—	—
Consumer and other loans	(9)	(2)	—	—	—
Total charge-offs	(537)	(42)	(4)	(366)	(162)
Recoveries:					
Real estate loans					
One-to-four family	—	—	—	—	—
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	—	—	—	—	—
Agricultural	—	—	—	—	—
Construction and land	—	—	—	—	—
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total recoveries	—	—	—	—	—
Net charge-offs	(537)	(42)	(4)	(366)	(162)
Allowance at end of period	\$ 922	\$ 1,008	\$ 855	\$ 751	\$ 857
Allowance to nonperforming loans	24.54%	24.13%	51.91%	37.81%	37.23%
Allowance to total loans outstanding at the end of the period	0.31	0.32	0.37	0.34	0.34
Net charge-offs to average loans outstanding during the period	0.18	0.01	0.00	0.16	0.06



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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 June 30, 2016			2015			2014		
	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans
	(Dollars in thousands)								
Real estate loans:									
One-to-four family	\$ 733	79.50%	82.56%	\$ 910	90.27%	82.57%	\$ 736	86.08%	
Multi-family	4	0.43	0.68	4	0.40	0.83	4	0.47	
Home equity	2	0.22	2.19	1	0.10	2.64	1	0.12	
Nonresidential	130	14.10	6.93	55	5.46	6.98	52	6.08	
Agricultural	5	0.54	1.01	4	0.40	1.34	—	—	
Construction and land	39	4.23	4.89	25	2.48	4.70	59	6.90	
Total real estate loans	913	99.02	98.26	999	99.11	99.06	852	99.65	
Commercial and industrial	6	0.65	0.06	—	—	0.06	—	—	
Consumer and other loans	3	0.33	1.68	9	0.89	0.88	3	0.35	
Total allowance for loan losses	\$ 922	100.00%	100.00%	\$ 1,008	100.00%	100.00%	\$ 855	100.00%	

	At June 30, 2013			2012		
	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category to Total Loans
	(Dollars in thousands)					
Real estate loans:						
One-to-four family	\$ 665	88.55%	91.61%	\$ 773	90.20%	92.82%
Multi-family	4	0.53	0.12	4	0.47	0.10
Home equity	1	0.13	0.13	1	0.12	0.16

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Nonresidential	52	6.92	3.82	56	6.53	3.66
Construction and land	27	3.60	3.91	21	2.45	2.87
Total real estate loans	749	99.73	99.59	855	99.77	99.61
Consumer and other loans	2	0.27	0.41	2	0.23	0.39
Total allowance for loan losses	\$ 751	100.00%	100.00%	\$ 857	100.00%	100.00%

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established our allowance for loan losses in conformity with accounting principles generally accepted in the United States of America, regulators, in reviewing our loan portfolio, may request us to increase our allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate and increases may be necessary should the quality of any loan deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.

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Investment Activities

General. The goals of our investment policy are to provide and maintain liquidity to meet deposit withdrawal and loan funding needs, to help manage our interest rate risk, and to generate a return on idle funds within the context of our interest rate and credit risk objectives.

Our board of directors approved and adopted our investment policy. The investment policy is reviewed annually by our board of directors and any changes to the policy are subject to the approval of our board of directors. Authority to make investments under the approved investment policy guidelines is delegated to our Investment Committee. All investment transactions are reviewed at regularly scheduled monthly meetings of our board of directors.

Our investment policy permits investments in securities issued by the United States government and its agencies or government sponsored enterprises. We also may invest in mortgage-backed securities and mutual funds that invest in mortgage-backed securities. Our investment policy also permits, with certain limitations, investments in bank-owned life insurance, collateralized mortgage obligations, asset-backed securities, real estate mortgage investment conduits, South Carolina revenue bonds and municipal securities. While equity investments are generally not authorized by our investment policy, such investments are permitted on a case-by-case basis provided such investments are pre-authorized by our board of directors.

At June 30, 2016, we did not have an investment in the securities of any single non-government issuer that exceeded 10% of equity at that date.

Our investment policy does not permit investment in stripped mortgage-backed securities, complex securities and derivatives as defined in federal banking regulations and other high-risk securities. As of June 30, 2016, we held no asset-backed securities other than mortgage-backed securities. Our current policies do not permit hedging activities, such as engaging in futures, options or swap transactions, or investing in high-risk mortgage derivatives, such as collateralized mortgage obligation residual interests, real estate mortgage investment conduit residual interests or stripped mortgage backed securities. At June 30, 2016, none of the collateral underlying our securities portfolio was considered subprime or Alt-A.

Current accounting principles require that, at the time of purchase, we designate a security as either held-to-maturity, available-for-sale, or trading, based upon our ability and intent. Securities available-for-sale and trading securities are reported at fair value and securities held-to-maturity are reported at amortized cost. All securities were classified as available-for-sale at June 30, 2016 and 2015. A periodic review and evaluation of our securities portfolios is conducted to determine if the fair value of any security has declined below its carrying value and whether such decline is other-than-temporary. If such decline is deemed to be other-than-temporary, the security is written down to a new cost basis and the resulting loss is charged against earnings. At June 30, 2016, the fair values of our securities are based on published or securities dealers' market values. At June 30, 2016, the amortized cost of our securities classified as available-for-sale was \$129.3 million compared to \$111.2 million at June 30, 2015. The fair value of securities classified as available-for-sale was \$132.1 million compared to \$111.2 million at June 30, 2015. The increase in securities classified as available-for-sale is a result of moderate loan demand, resulting in excess cash liquidity.

U.S. Government and Federal Agency Obligations. We may invest in U.S. Government and federal agency securities. 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, as collateral for borrowings and for prepayment protection.

Mortgage-Backed Securities. At June 30, 2016, the amortized cost and fair value of our mortgage-backed securities portfolio totaled \$68.1 million and \$69.4 million, respectively. Mortgage-backed securities are securities issued in the secondary market that are collateralized by pools of mortgages. Certain types of mortgage-backed securities are commonly referred to as "pass-through" certificates because the principal and interest of the underlying loans is "passed through" to investors, net of certain costs, including servicing and guarantee fees. Mortgage-backed securities typically are collateralized by pools of one-to-four family or multifamily mortgages, although we invest primarily in mortgage-backed 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 the Company. The interest rate of the security is lower than the interest rates of the underlying loans to allow for payment of servicing and guaranty fees. Ginnie Mae,

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United States Government agency, and government sponsored enterprises, such as Fannie Mae and Freddie Mac, either guarantee the payments or guarantee the timely payment of principal and interest to investors. Mortgage-backed securities are more liquid than individual mortgage loans since there is an active trading market for such securities. In addition, mortgage-backed securities may be used to collateralize our borrowings.

Investments in mortgage-backed securities involve a risk that actual payments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or accretion of any discount relating to such interests, thereby affecting the net yield on our securities. Current prepayment speeds determine whether prepayment estimates require modification that could cause amortization or accretion adjustments. Also, in September 2008, the Federal Housing Finance Agency placed Freddie Mac and Fannie Mae into conservatorship. The U.S. Treasury Department has established financing agreements to ensure that Freddie Mac and Fannie Mae meet their obligations to holders of mortgage-backed securities that they have issued or guaranteed. These actions have not affected the markets for mortgage-backed securities issued by Freddie Mac or Fannie Mae. Both Freddie Mac and Fannie Mae remain in conservatorship with the Federal Housing Finance Agency. All of our mortgage-backed securities are issued by government agencies or government-sponsored entities.

**Restricted Equity Securities.** We invest in the common stock of the Federal Home Loan Bank of Atlanta and in preferred and common stock of First National Bankers Bancshares, Inc. The stock is carried at cost and classified as restricted equity securities. We periodically evaluate the stock for impairment based on ultimate recovery of par value.

**Bank-Owned Life Insurance.** We invest in bank-owned life insurance to provide us with a funding source for deferred compensation agreements. Bank-owned life insurance also generally provides us noninterest income that is non-taxable. Federal regulations generally limit our investment in bank-owned life insurance to 25% of our Tier 1 capital plus our allowance for loan losses. At June 30, 2016 and 2015, we had \$17.6 million and \$9.0 million, respectively, invested in bank-owned life insurance. During September 2015 we purchased an additional \$8.0 million in bank owned life insurance.

**Securities Portfolio Composition.** The following table sets forth the composition of our securities portfolio at the dates indicated:

	At June 30,		2015		2014	
	Amortized	Fair	Amortized	Fair	Amortized	Fair
	Cost	Value	Cost	Value	Cost	Value
	(Dollars in thousands)					
Securities available-for-sale:						
FHLMC common stock	\$ 20	\$ 151	\$ 20	\$ 180	\$ 20	\$ 314
Preferred stock	—	—	—	—	271	298
Certificates of deposit	7,470	7,534	7,221	7,242	7,221	7,237
Corporate debt securities	8,932	9,116	—	—	—	—
Municipal securities	33,508	34,481	13,574	13,433	5,846	5,809
SBA loan pools	1,268	1,273	2,249	2,266	—	—
U.S. Government agency mortgage-backed securities	68,103	69,403	64,177	64,142	60,742	60,440
U.S. Government agencies	9,957	10,126	23,967	23,904	29,946	29,708
Total available-for-sale	\$ 129,258	\$ 132,084	\$ 111,208	\$ 111,167	\$ 104,046	\$ 103,806

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Securities Portfolio Maturities and Yields. The following table sets forth the contractual maturities and weighted average yields of our securities portfolio at June 30, 2016. Mortgage-backed securities are anticipated to be repaid in advance of their contractual maturities as a result of projected mortgage loan prepayments. The weighted average life of the mortgage-backed securities in our portfolio at June 30, 2016 was 4.0 years.

	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
(Dollars in thousands)						
Securities available-for-sale:						
FHLMC common stock	\$ —	—%	\$ —	0.00%	\$ —	—%
Certificates of deposit	2,739	1.00	4,482	1.55	249	2.35
Corporate debt securities	—	—	3,052	1.88	5,880	2.56
Municipal securities	—	—	3,296	2.55	21,682	3.17
SBA loan pools	—	—	1,268	2.65	—	—
U.S. Government agency mortgage-backed securities	—	—	59,668	2.11	8,435	2.16
U.S. Government agency bonds	1,001	1.10	1,995	1.53	6,961	1.87
Total available-for-sale	\$ 3,740	1.03%	\$ 73,761	2.00%	\$ 43,207	2.33%

	More than Ten Years		Total	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
(Dollars in thousands)				
Securities available-for-sale:				
FHLMC common stock	\$ 20	—%	\$ 20	—%
Certificates of deposit	—	—	7,470	1.38
Corporate debt securities	—	—	8,932	2.33
Municipal securities	8,530	3.79	33,508	3.26
SBA loan pools	—	—	1,268	2.65
U.S. Government agency mortgage-backed securities	—	—	68,103	2.12
U.S. Government agency bonds	—	—	9,957	1.73
Total available-for-sale	\$ 8,550	3.78%	\$ 129,258	2.20%

**Sources of Funds**

General. Deposits have traditionally been our primary source of funds for use in lending and investment activities. We also may use borrowings, primarily Federal Home Loan Bank of Atlanta advances, to supplement cash flow needs, lengthen the maturities of liabilities for interest rate risk purposes and to manage the cost of funds. In addition, we receive 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 interest rates, market

conditions and levels of competition.

Deposits. We accept deposits from Oconee County, South Carolina, and Stephens and Rabun Counties, Georgia and surrounding counties and townships. We offer a selection of deposit accounts, including demand accounts, NOW accounts, money market accounts, savings accounts, certificates of deposit and individual retirement accounts (“IRAs”). Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and

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the interest rate. We do not accept brokered deposits, although we have the authority to do so. We very rarely accept certificates of deposit in excess of \$250 thousand or other deposits in excess of applicable FDIC insurance coverage, which is currently \$250 thousand per depositor.

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. We rely upon personalized customer service, long-standing relationships with customers, and the favorable image of Oconee Federal Savings and Loan Association in the community to attract and retain deposits. We also offer a fully functional electronic banking platform, including on-line bill pay, and mobile banking as services to our deposit customers.

The flow of deposits is influenced significantly by general economic conditions, changes in interest rates and competition. Our ability to gather deposits is affected by the competitive market in which we operate, which includes numerous financial institutions of varying sizes offering a wide range of products.

The following table sets forth the distribution of total deposits by account type, at the dates indicated:

	At June 30,		2015		2014	
	2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
NOW and demand deposits(1)	\$ 72,201	18.07%	\$ 71,208	18.07%	\$ 26,334	9.37%
Money market deposits	74,774	18.71	17,514	4.44	12,459	4.43
Regular savings and other deposits	28,677	7.18	48,821	12.39	41,945	14.93
Certificates of deposit – IRA	62,111	15.54	66,670	16.92	54,646	19.45
Certificates of deposit – other	161,871	40.50	189,880	48.18	145,631	51.82
Total	\$ 399,634	100.00%	\$ 394,093	100.00%	\$ 281,015	100.00%

(1)

Includes noninterest bearing deposits of \$23.4 million and \$20.3 million at June 30, 2016 and 2015, respectively.

As of June 30, 2016, the aggregate amount of our outstanding certificates of deposit in amounts greater than or equal to \$250 thousand was approximately \$11.1 million. The following table sets forth the maturity of these certificates of deposit as of June 30, 2016:

	June 30, 2016
	Certificates of Deposit
	(Dollars in thousands)
Maturity Period:	
Three months or less	\$ 2,611
Over three through six months	810
Over six through twelve months	3,354
Over twelve months	4,359
Total	\$ 11,134



Borrowings. We may obtain advances from the Federal Home Loan Bank of Atlanta by pledging as security our capital stock in the Federal Home Loan Bank of Atlanta and certain of our mortgage loans and mortgage-backed securities. Such advances may be made pursuant to several different credit programs, each of which has its own interest rate and range of maturities. To the extent such borrowings have different repricing terms from our deposits, borrowings can change our interest rate risk profile.

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We had no borrowings from the Federal Home Loan Bank of Atlanta at June 30, 2016 and June 30, 2015. At June 30, 2016, we had access to Federal Home Loan Bank of Atlanta advances of up to \$53.4 million. That amount was increased to \$121.4 million subsequent to year-end. It is possible that we may use Federal Home Loan Bank of Atlanta advances or other short-term borrowings to fund loan demand or to purchase securities in the future.

**Subsidiary and Other Activities**

Oconee Federal Financial Corp. has no subsidiaries other than Oconee Federal Savings and Loan Association, and Oconee Federal Savings and Loan Association has no subsidiaries.

**Personnel**

As of June 30, 2016, we had 80 full-time employees and one part-time employee. Our employees are not represented by any collective bargaining group. Management believes that we have good working relations with our employees.

**FEDERAL AND STATE TAXATION**

**Expense and Tax Allocation**

Oconee Federal Savings and Loan Association has entered into an agreement with Oconee Federal Financial Corp. and Oconee Federal, MHC to provide them with certain administrative support services for compensation not less than the fair market value of the services provided. In addition, Oconee Federal Savings and Loan Association and Oconee Federal Financial Corp. have entered into an agreement to establish a method for allocating and for reimbursing the payment of their consolidated tax liability.

**Federal Taxation**

**General.** Oconee Federal Financial Corp. and Oconee Federal Savings and Loan Association are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Oconee Federal Financial Corp. or Oconee Federal Savings and Loan Association.

**Method of Accounting.** For federal income tax purposes, Oconee Federal Savings and Loan Association currently reports its income and expenses on the accrual method of accounting and uses a tax year ending June 30 for filing its federal income tax returns.

**Bad Debt Reserves.** Prior to the Small Business Protection Act of 1996 (the "1996 Act"), Oconee Federal Savings and Loan Association and similar savings institutions were permitted to establish reserves for bad debts and to make annual additions to the reserve using several methods. For taxable years beginning after 1995, savings institutions are permitted to compute their bad debt deductions only to the same extent that banks are permitted. Accordingly, "small" savings institutions with less than \$500 million in assets may maintain a reserve using the experience method, and "large" savings institutions with more than \$500 million in assets are required to use the specific charge-off method. Oconee Federal Savings and Loan Association currently has less than \$500 million in assets and uses the experience method to determine its annual additions to its tax bad debt reserves. Under the experience method, a savings institution is allowed a deduction for amounts that it adds to its bad debt reserve in accordance with Internal Revenue Code Section 585. Instead of taking a direct deduction when a debt becomes worthless, the savings institution charges off the debt against its reserve. The determination of whether and when a debt becomes worthless is made in the same manner as under the specific charge-off method. The savings institution calculates its addition to its bad debt reserve at the end of each year.

These additions are, within specified formula limits, deducted in arriving at taxable income. Pursuant to the 1996 Act, Oconee Federal Savings and Loan Association was required to recapture into taxable income a portion of its bad debt reserve. Savings institutions were required to recapture any reserves in excess of the amounts allowed except for reserves established after the end of the base year. For Oconee Federal Savings and Loan Association, the reserve balance as of June 30, 1987 is preserved and is referred to as the base year reserve. The experience method authorizes a savings institution to add to its reserve at

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least the amount required to maintain the reserve balance as it existed at the end of its base year, even if this addition causes the reserve to exceed the permissible level computed using the experience method alone.

**Taxable Distributions and Recapture.** Prior to the 1996 Act, federal tax bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income if the thrift institution failed to meet certain thrift asset and definitional tests. Federal legislation has eliminated these thrift-related recapture rules.

At June 30, 2016, our total federal and South Carolina pre-1988 base year tax bad debt reserve was approximately \$5.3 million. Under current law, pre-1988 federal base year reserves remain subject to recapture if a thrift institution makes certain non-dividend distributions, certain repurchases any of its stock, pays dividends in excess of tax earnings and profits, or ceases to maintain a thrift or bank charter.

**Alternative Minimum Tax.** The Internal Revenue Code of 1986, as amended imposes an alternative minimum tax (“AMT”) at a rate of 20% on a base of regular taxable income plus certain tax preferences (“alternative minimum taxable income” or “AMTI”). The AMT is payable to the extent such AMTI is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses can offset no more than 90% of AMTI. Certain payments of AMT may be used as credits against regular tax liabilities in future years. Oconee Federal Financial Corp. and Oconee Federal Savings and Loan Association have not been subject to the AMT and have no such amounts available as credits for carryover.

**Net Operating Loss Carryovers.** A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. A net operating loss carryforward of \$375 thousand was acquired as part of the Stephens Federal acquisition. At June 30, 2016 and 2015, \$360 thousand and \$364 thousand, respectively, of this carryforward remained.

**Corporate Dividends-Received Deduction.** Oconee Federal Financial Corp. may exclude from its income 100% of dividends received from Oconee Federal Savings and Loan Association as a member of the same affiliated group of corporations. The corporate dividends-received deduction is generally 80% in the case of dividends received from 20%-or-more-owned domestic corporations and 70% in the case of dividends received from less-than-20%-owned domestic corporations.

### State and Local Taxation

**State Taxation.** Oconee Federal Financial Corp. files a South Carolina income tax return, and Oconee Federal Savings and Loan Association files South Carolina and Georgia income tax returns. State income tax rates are 4.5% to 6% in South Carolina and 6% in Georgia. For these purposes, state taxable income generally means federal taxable income subject to certain modifications, primarily the exclusion of interest income on United States obligations, state income tax deductions, and adjustments for bonus depreciation deductions. Oconee Federal Savings and Loan also files and pays business personal property tax and Business Occupation Tax in the state of Georgia.

## SUPERVISION AND REGULATION

### General

As a federal savings association, Oconee Federal Savings and Loan Association is subject to examination and regulation by the OCC, and is also subject to examination by the FDIC. The federal system of regulation and supervision establishes a comprehensive framework of activities in which Oconee Federal Savings and Loan Association may engage and is intended primarily for the protection of depositors and the FDIC’s Deposit Insurance Fund, and not for the protection of security holders. Under this system of federal regulation, financial institutions are periodically examined to ensure that they satisfy applicable standards with respect to their capital adequacy, assets, management, earnings, liquidity and sensitivity to market interest rates. Oconee Federal Savings and Loan Association also is regulated to a lesser extent by the Federal Reserve Board, which governs the reserves to be maintained against deposits and other matters. Oconee Federal Savings and Loan Association must comply with consumer protection regulations issued by the Consumer Financial Protection Bureau. Oconee Federal Savings and Loan Association also is a member of and owns stock in the Federal Home Loan Bank of Atlanta, which is one of the eleven regional banks in the Federal Home Loan Bank System. The OCC examines Oconee Federal Savings and Loan Association and prepares reports for the consideration of its Board of Directors on any

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operating deficiencies. Oconee Federal Savings and Loan Association's relationship with its depositors and borrowers also is regulated to a great extent by federal law and, to a much lesser extent, state law, especially in matters concerning the ownership of deposit accounts, the form and content of Oconee Federal Savings and Loan Association's loan documents and certain consumer protection matters.

As savings and loan holding companies, Oconee Federal Financial Corp. and Oconee Federal, MHC are subject to examination and supervision by, and are required to file certain reports with, the Federal Reserve Board.

Set forth below are certain material regulatory requirements that are applicable to Oconee Federal Savings and Loan Association, Oconee Federal Financial Corp. and Oconee Federal, MHC. This description of statutes and regulations is not intended to be a complete description of such statutes and regulations and their effects on us. Any change in these laws or regulations, whether by Congress or the applicable regulatory agencies, could have a material adverse impact on us and our operations.

**Federal Legislation**

The Dodd-Frank Act made significant changes to the regulatory structure for depository institutions and their holding companies. However, the Dodd-Frank Act's changes go well beyond that and affect the lending, investments and other operations of all depository institutions. The Dodd-Frank Act required the Federal Reserve Board to set minimum capital levels for both bank holding companies and savings and loan holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital for holding companies were restricted to capital instruments that were then currently considered to be Tier 1 capital for insured depository institutions. The legislation also established a floor for capital of insured depository institutions that cannot be lower than the standards in effect upon passage, and directed the federal banking regulators to implement new leverage and capital requirements that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as Oconee Federal Savings and Loan Association, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets are still examined for compliance by their applicable bank regulators. The new legislation also weakened the federal preemption available for national banks and federal savings associations, and gave state attorneys general the ability to enforce applicable federal consumer protection laws.

The Dodd-Frank Act broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution, rather than on total deposits. The legislation also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2008. The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments. The legislation also directed the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not. Further, the legislation required that originators of securitized loans retain a percentage of the risk for transferred loans, directed the Federal Reserve Board to regulate pricing of certain debit card interchange fees and contained a number of reforms related to mortgage origination.

Many provisions of the Dodd-Frank Act involved delayed effective dates and/or required implementing regulations that are being issued over time. Their impact on our operations cannot yet be fully assessed. However, it is likely that the Dodd-Frank Act will result in an increased regulatory burden and compliance, operating and interest expense for Oconee Federal Savings and Loan Association and Oconee Federal Financial Corp.

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### Federal Banking Regulation

**Business Activities.** A federal savings and loan association derives its lending and investment powers from the Home Owners' Loan Act, as amended, and the federal regulations thereunder. Under these laws and regulations, Oconee Federal Savings and Loan Association may invest in mortgage loans secured by residential and commercial real estate, commercial business and consumer loans, certain types of debt securities and certain other assets, subject to applicable limits. Oconee Federal Savings and Loan Association also may establish subsidiaries that may engage in certain activities not otherwise permissible for Oconee Federal Savings and Loan Association, including real estate investment and securities and insurance brokerage. The Dodd-Frank Act authorized banks and savings and loan associations to pay interest on business checking accounts, effective July 21, 2011.

**Capital Requirements.** On January 1, 2015, the OCC and the other federal bank regulatory agencies made effective a final rule which revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The revised requirements apply to all depository institutions and top-tier bank and savings and loan holding companies with total consolidated assets of \$1 billion or more.

The revised risk-based capital standards require the maintenance of common equity Tier 1 capital, Tier 1 capital and total capital to risk-weighted assets of at least 4.5%, 6% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets (e.g., recourse obligations, direct credit substitutes, residual interests) are multiplied by a risk weight factor (from 0% to 1,250%) assigned by the regulations based on the risks believed inherent in the type of asset. Higher levels of capital are required for asset categories believed to present greater risk. Common equity Tier 1 capital is generally defined as common stockholders' equity and retained earnings. Tier 1 capital is generally defined as common equity Tier 1 and additional Tier 1 capital. Additional Tier 1 capital includes certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries. Total capital includes Tier 1 capital (common equity Tier 1 capital plus additional Tier 1 capital) and Tier 2 capital. Tier 2 capital is comprised of capital instruments and related surplus, meeting specified requirements, and may include cumulative preferred stock and long-term perpetual preferred stock, mandatory convertible securities, intermediate preferred stock and subordinated debt. Also included in Tier 2 capital is the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and for institutions, such as Oconee Federal Savings and Loan Association, that have exercised an opt-out election regarding the treatment of Accumulated Other Comprehensive Income, up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Oconee Federal Savings and Loan Association exercised the one-time permanent opt-out election in order to reduce the impact of market volatility on its regulatory capital levels. Calculation of all types of regulatory capital is subject to deductions and adjustments specified in the regulations. In assessing an institution's capital adequacy, the Federal Reserve takes into consideration, not only these numeric factors, but qualitative factors as well, and has the authority to establish higher capital requirements for individual associations where necessary.

In addition to establishing the minimum regulatory capital requirements, the regulations limit capital distributions and certain discretionary bonus payments to management if the institution does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted asset above the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement is being phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increasing each year until fully implemented at 2.5% on January 1, 2019.

We have conducted an analysis of the application of these new capital requirements as of June 30, 2016. We have determined that we meet all of these new requirements, including the full 2.5% capital conservation buffer, as if these new requirements had been in effect on that date.

**Loans-to-One Borrower.** Generally, a federal savings and loan association may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of June 30, 2016, Oconee Federal Savings and Loan Association's largest lending relationship with a single or related group of



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borrowers totaled \$3.5 million, which represented 4.1% of unimpaired capital and surplus; therefore, Oconee Federal Savings and Loan Association was in compliance with the loans-to-one borrower limitations.

**Qualified Thrift Lender Test.** As a federal savings and loan association, Oconee Federal Savings and Loan Association is subject to a qualified thrift lender, or “QTL” test. Under the QTL test, Oconee Federal Savings and Loan Association must either qualify as a “domestic building and loan association” within the meaning of Internal Revenue Code or maintain at least 65% of its “portfolio assets” in “qualified thrift investments” (primarily residential mortgage loans and related investments, including mortgage-backed securities) in at least nine months of the most recent 12-month period. “Portfolio assets” generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings and loan association’s business.

A savings and loan association that fails the qualified thrift lender test must operate under specified restrictions set forth in the Home Owners’ Loan Act. In addition, the Dodd-Frank Act made non-compliance with the QTL test subject to agency enforcement action for a violation of law. At June 30, 2016, Oconee Federal Savings and Loan Association maintained approximately 77% of its portfolio assets in qualified thrift investments and, therefore, satisfied the QTL test.

**Capital Distributions.** Federal regulations govern capital distributions by a federal savings and loan association, which include cash dividends, stock repurchases and other transactions charged to the savings and loan association’s capital account. A federal savings association must file an application with the OCC for approval of a capital distribution if:

- the total capital distributions for the applicable calendar year exceed the sum of the association’s net income for that year to date plus the association’s retained net income for the preceding two years;
- the association would not be at least adequately capitalized following the distribution;
- the distribution would violate any applicable statute, regulation, agreement or regulatory-imposed condition; or
- the association is not eligible for expedited treatment of its application or notice filings.

Even if an application is not otherwise required, every savings association that is a subsidiary of a holding company must still file a notice with the Federal Reserve Board at least 30 days before its board of directors declares a dividend or approves a capital distribution.

A notice or application for a capital distribution may be disapproved if:

- the association would be undercapitalized following the distribution;
- the proposed capital distribution raises safety and soundness concerns; or
- the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

In addition, the Federal Deposit Insurance Act provides that an insured depository institution may not make any capital distribution, if after making such distribution, the institution would fail to meet any applicable regulatory capital requirement. A federal savings association also may not make a capital distribution that would reduce its regulatory capital below the amount required for the liquidation account established in connection with its conversion to stock form. In addition, beginning in 2016, Oconee Federal Savings and Loan Association’s ability to pay dividends

will be limited if Oconee Federal Savings and Loan Association does not have the capital conservation buffer required by the new capital rules, which may limit the ability of Oconee Federal Financial Corp. to pay dividends to its stockholders. See “— Capital Requirements.”

Liquidity. A federal savings and loan association is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation. We seek to maintain a ratio of liquid assets not subject to pledge as a percentage of deposits and borrowings of 4.0% or greater of highly liquid assets. At June 30, 2016, this ratio was 40.0%. Total cash and cash equivalents was 6.9% of total deposits at June 30, 2016.

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Community Reinvestment Act and Fair Lending Laws. All federal savings and loan associations have a responsibility under the Community Reinvestment Act and related regulations to help meet the credit needs of their communities, including low- and moderate-income borrowers. An association's record of compliance with the Community Reinvestment Act is assessed in regulatory examinations. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An association's failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in denial of certain corporate applications, such as branches or mergers, or in restrictions on its activities. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by regulators and the Department of Justice. Oconee Federal Savings and Loan Association received a "satisfactory" Community Reinvestment Act rating in its most recent federal examination.

Transactions with Related Parties. A federal savings and loan association's authority to engage in transactions with its "affiliates" is limited by OCC regulations and by Sections 23A and 23B of the Federal Reserve Act and its implementing Regulation W. The term "affiliate" for these purposes generally means any company that controls, is controlled by, or is under common control with an insured depository institution such as Oconee Federal Savings and Loan Association. Oconee Federal Financial Corp. and Oconee Federal, MHC are affiliates of Oconee Federal Savings and Loan Association. In general, transactions with affiliates must be on terms that are as favorable to the savings and loan association as comparable transactions with non-affiliates and are subject to certain quantitative limits and collateral requirements. In addition, savings and loan associations are prohibited from lending to any affiliates that are engaged in activities that are not permissible for bank holding companies and from purchasing the securities of any affiliate, other than a subsidiary. Transactions with affiliates also must be consistent with safe and sound banking practices, and not involve the purchase of low-quality assets.

Oconee Federal Savings and Loan Association's authority to extend credit to its directors, executive officers and 10% shareholders, as well as to entities controlled by such persons, is currently governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board. Among other things, those provisions require that extensions of credit to insiders:

- be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features (subject to certain exemptions for lending programs that are available to all employees); and

- not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of Oconee Federal Savings and Loan Association's capital.

In addition, Oconee Federal Savings and Loan Association's board of directors must approve extensions of credit in excess of certain limits.

Enforcement. The OCC has primary enforcement responsibility over federal savings and loan associations, including the authority to bring enforcement action against all "institution-affiliated parties," including stockholders, and attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order, to removal of officers and/or directors of the institution, receivership, conservatorship or the termination of deposit insurance. Civil penalties cover a wide range of violations and actions, and range up to \$25 thousand per day, unless a finding of reckless disregard is made, in which case penalties may be as high as \$1.0 million per day. The FDIC also has the authority to terminate deposit insurance or to recommend to the OCC that enforcement action be taken with respect to a particular savings institution. If the regulator does not take action, the FDIC has authority to take action under specified circumstances.

Standards for Safety and Soundness. Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards required under federal law.

These standards relate to, among other things, internal controls,

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information security systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. Failure to implement such a plan can result in further enforcement action, including the issuance of a cease and desist order or the imposition of civil money penalties.

**Prompt Corrective Action Regulations.** Under the prompt corrective action regulations, the regulators are authorized and, under certain circumstances, required to take supervisory actions against undercapitalized savings and loan associations. For this purpose, a savings and loan association is placed in one of five categories based on the association's capital. The final capital rule effective in January 2015 revised the prompt corrective action categories to incorporate the revised regulatory capital requirements.

An institution is deemed to be "well capitalized" if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a leverage ratio of 5.0% or greater and a common equity Tier 1 ratio of 6.5% or greater. An institution is "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, a leverage ratio of 4.0% or greater and a common equity Tier 1 ratio of 4.5% or greater. An institution is "undercapitalized" if it has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 6.0%, a leverage ratio of less than 4.0% or a common equity Tier 1 ratio of less than 4.5%. An institution is deemed to be "significantly undercapitalized" if it has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 4.0%, a leverage ratio of less than 3.0% or a common equity Tier 1 ratio of less than 3.0%. An institution is considered to be "critically undercapitalized" if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%.

At each successive lower capital category, an insured depository institution is subject to more restrictions and prohibitions, including restrictions on growth, restrictions on interest rates paid on deposits, restrictions or prohibitions on payment of dividends, and restrictions on the acceptance of brokered deposits. Furthermore, if an insured depository institution is classified in one of the undercapitalized categories, it is required to submit a capital restoration plan to the appropriate federal banking agency, and the holding company must guarantee the performance of that plan. Based upon its capital levels, an institution that is classified as well-capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment. An undercapitalized institution's compliance with a capital restoration plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5.0% of the institution's total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized. If an "undercapitalized" institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized." "Significantly undercapitalized" institutions must comply with one or more of a number of additional restrictions. Such restrictions may include, but are not limited to, an order by the regulator to: (i) sell sufficient voting stock to become adequately capitalized, (ii) reduce total assets, (iii) cease receipt of deposits from correspondent banks, (iv) dismiss directors or officers, (v) restrict interest rates paid on deposits, (vi) limit compensation of executive officers and/or (vii) limit capital distributions by the parent holding company. "Critically undercapitalized" institutions are subject to additional measures including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

At June 30, 2016, Oconee Federal Savings and Loan Association met the criteria for being considered "well-capitalized."

**Insurance of Deposit Accounts.** Deposit accounts in Oconee Federal Savings and Loan Association are insured by the FDIC's Deposit Insurance Fund, generally up to a maximum of \$250 thousand per separately insured depositor and up to a maximum of \$250 thousand for self-directed retirement accounts.

The FDIC assesses insured depository institutions to maintain the Deposit Insurance Fund. No institution may pay a dividend if in default of its deposit insurance assessment.



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Under the FDIC's risk-based assessment system, insured institutions are assessed based on perceived risk to the Deposit Insurance Fund. Originally, each institution was assigned to a risk category based on supervisory evaluations, regulatory capital levels and certain other factors. An institution's assessment rate depended upon the category to which it is assigned and certain adjustments specified by FDIC regulations, with less risky institutions paying lower rates. Assessment rates (inclusive of possible adjustments) ranged from 2 1/2 to 45 basis points of each institution's total assets less tangible capital. In conjunction with the Deposit Insurance Fund's reserve ratio reaching 1.15%, the range of assessments for banks of less than \$10 billion in assets was reduced to 1 1/2 basis points to 30 basis points of total assets less tangible capital, effective July 1, 2016. In addition, the risk categories were eliminated in favor of a combination of examination ratings and financial modeling designed to estimate the probability that an institution fails over a three year period.

The FDIC has the authority to increase insurance assessments. A material increase would likely have an adverse effect on the operating expenses and results of operations of Oconee Federal Savings and Loan Association. Management cannot predict what insurance assessment rates will be in the future.

In addition to the FDIC assessments, the Financing Corporation ("FICO") is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. For the quarter ended June 30, 2016, the annualized FICO assessment rate equaled 0.56 basis points of total assets less tier 1 capital. The bonds issued by the FICO are due to mature in 2017 through 2019.

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

**Prohibitions Against Tying Arrangements.** Federal savings and loan associations are prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

**Federal Home Loan Bank System.** Oconee Federal Savings and Loan Association is a member of the Federal Home Loan Bank System, which consists of eleven regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions as well as other entities involved in home mortgage lending. As a member of the Federal Home Loan Bank of Atlanta, Oconee Federal Savings and Loan Association is required to acquire and hold shares of capital stock in the Federal Home Loan Bank. As of June 30, 2016, Oconee Federal Savings and Loan Association was in compliance with this requirement.

### **Other Regulations**

Interest and other charges collected or contracted for by Oconee Federal Savings and Loan Association are subject to state usury laws and federal laws concerning interest rates. Oconee Federal Savings and Loan Association's operations are also subject to federal laws applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one-to-four family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;



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- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

- Truth in Savings Act; and

- rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

In addition, the Consumer Financial Protection Bureau issues regulations and standards under these federal consumer protection laws that affect our consumer businesses. These include regulations setting “ability to repay” and “qualified mortgage” standards for residential mortgage loans and mortgage loan servicing and originator compensation standards. Oconee Federal Savings and Loan Association is evaluating recent regulations and proposals, and devotes significant compliance, legal and operational resources to compliance with consumer protection regulations and standards.

The operations of Oconee Federal Savings and Loan Association also are subject to the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers’ rights and liabilities arising from the use of automated teller machines and other electronic banking services;

- Check Clearing for the 21st Century Act (also known as “Check 21”), which gives “substitute checks,” such as digital check images and copies made from that image, the same legal standing as the original paper check;

- The USA PATRIOT Act, which requires savings and loan associations to, among other things, establish broadened anti-money laundering compliance programs, and due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements that also apply to financial institutions under the Bank Secrecy Act and the Office of Foreign Assets Control regulations; and

- The Gramm-Leach-Bliley Act, which places limitations on the sharing of consumer financial information by financial institutions with unaffiliated third parties. Specifically, the Gramm-Leach-Bliley Act requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution’s privacy policy and provide such customers the opportunity to “opt out” of the sharing of certain personal financial information with unaffiliated third parties.

Holding Company Regulation

General. Oconee Federal, MHC and Oconee Federal Financial Corp. are non-diversified savings and loan holding companies within the meaning of the Home Owners’ Loan Act. As such, Oconee Federal, MHC and Oconee Federal Financial Corp. are registered savings and loan holding companies and are subject to regulations, examinations, supervision by and reporting to the Federal Reserve Board. In addition, the Federal Reserve Board has enforcement authority over Oconee Federal Financial Corp. and Oconee Federal, MHC, and their non-savings institution

subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a serious risk to Oconee Federal Savings and Loan Association.

Permitted Activities. The business activities of savings and loan holding companies are generally limited to those activities permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act of 1956, as amended, provided certain conditions are met, or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance as well as activities that are incidental to

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financial activities or complementary to a financial activity. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to regulatory approval, and certain additional activities authorized by federal regulations.

Federal law prohibits a savings and loan holding company, including Oconee Federal Financial Corp. and Oconee Federal, MHC, directly or indirectly, or through one or more subsidiaries, from acquiring another savings institution or holding company thereof, without prior regulatory approval. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a class of voting stock of a nonsubsidiary savings institution, a nonsubsidiary holding company, or a nonsubsidiary company engaged in activities other than those permitted for a savings and loan holding company; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board evaluates such factors as the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the Deposit Insurance Fund, the convenience and needs of the community, and competitive factors.

No acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state may be approved, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

**Capital.** Savings and loan holding companies historically have not been subject to consolidated regulatory capital requirements. The Dodd-Frank Act, however, required the Federal Reserve Board to establish for all depository institution holding companies minimum consolidated capital requirements that are as stringent as those required for the insured depository subsidiaries. The components of Tier 1 capital are restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions, which excludes instruments such as trust preferred securities and cumulative preferred stock. Instruments issued before May 19, 2010 are grandfathered in for companies with consolidated assets of \$15 billion or less. The final capital rule discussed above implemented the consolidated capital requirements for savings and loan holding companies, effective January 1, 2015. However, holding companies with less than \$1 billion of assets (which currently includes the Company) are exempted from the consolidated capital requirements unless otherwise advised by the Federal Reserve Board.

**Source of Strength.** The Dodd-Frank Act extended the “source of strength” doctrine to savings and loan holding companies. The Federal Reserve Board has issued regulations requiring that all savings and loan holding companies serve as a source of managerial and financial strength to their subsidiary savings associations by providing capital, liquidity and other support in times of financial stress.

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

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The level of any dividends that may be paid by Oconee Federal Financial Corp. will also be affected by the ability of Oconee Federal, MHC to waive the receipt of dividends.

**Waivers of Dividends by Oconee Federal, MHC.** Oconee Federal Financial Corp. may pay dividends on its common stock to public shareholders. If it does, it is also required to pay dividends to Oconee Federal, MHC, unless Oconee Federal, MHC elects to waive the receipt of dividends. Under the Dodd-Frank Act, Oconee Federal, MHC must receive the approval of the Federal Reserve Board before it may waive the receipt of any dividends from Oconee Federal Financial Corp. The Federal Reserve Board has issued an interim final rule providing that it will not object to dividend waivers under certain circumstances, including circumstances where the waiver is not detrimental to the safe and sound operation of the savings association and a majority of the mutual holding company's members have approved the waiver of dividends by the mutual holding company within the previous twelve months. There can be no assurance that a particular dividend waiver request would be approved by the Federal Reserve Board. In addition, any dividends waived by Oconee Federal, MHC must be considered in determining an appropriate exchange ratio in the event of a conversion of the mutual holding company to stock form.

**Conversion of Mutual Holding Company to Stock Form.** Federal regulations permit a mutual holding company to convert from the mutual form of organization to the capital stock form of organization (a "Conversion Transaction"). In a Conversion Transaction a new holding company would be formed as the successor to Oconee Federal Financial Corp. (the "New Holding Company"), Oconee Federal, MHC's corporate existence would end, and certain depositors of Oconee Federal Savings and Loan Association would receive the right to subscribe for additional shares of the New Holding Company. There can be no assurance that such a conversion transaction will occur.

**Acquisition.** Under the Federal Change in Bank Control Act, a notice must be submitted to the Federal Reserve Board if any person (including a company), or group acting in concert, seeks to acquire direct or indirect "control" of a savings and loan holding company. Under certain circumstances, a change of control may occur, and prior notice is required, upon the acquisition of 10% or more of the company's outstanding voting stock, unless the Federal Reserve Board has found that the acquisition will not result in control of the company. A change in control definitively occurs upon the acquisition of 25% or more of the company's outstanding voting stock. Under the Change in Bank Control Act, the Federal Reserve Board generally has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition.

**Federal Securities Laws**

Oconee Federal Financial Corp.'s common stock is registered with the Securities and Exchange Commission. Oconee Federal Financial Corp. is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

**Sarbanes-Oxley Act of 2002**

The Sarbanes-Oxley Act of 2002 addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by the Sarbanes-Oxley Act, our Chief Executive Officer and Chief Financial Officer are required to certify that our quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal control over financial reporting; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal control over financial reporting; and they have included information in our quarterly and annual reports about their evaluation and whether there have been changes in our internal control over financial reporting or in other factors that could materially affect internal control over financial reporting.

**ITEM 1A. Risk Factors**

Disclosures of risk factors are not required by smaller reporting companies, such as the Company.

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## ITEM 1B. Unresolved Staff Comments

None.

## ITEM 2. Properties

As of June 30, 2016, the net book value of our properties was \$6.3 million. The following is a list of our offices:

Location	Year Acquired	Square Footage	Net Book Value of Real Property	
(Dollars in thousands)				
Main Office:				
115 E. North 2nd St. Seneca, South Carolina	Owned	1966	7,000	\$ 850
Main Office Annex:				
201 E. North 2nd St. Seneca, South Carolina	Owned	1996	7,500	608
Branch Offices:				
813 123 By-Pass Seneca, South Carolina	Owned	1985	5,250	508
204 W. North Broad St. Walhalla, South Carolina	Owned	1973	3,100	372
111 W. Windsor St. Westminster, South Carolina	Owned	1972	3,200	259
2859 Highway 17 Alternate Toccoa, Georgia	Owned	2014	17,007	2,456
12 East Doyle St. Toccoa, Georgia	Owned	2014	5,548	276
221 Highway 76 East Clayton, Georgia	Owned	2014	5,851	1,018
				\$ 6,347

We believe that current facilities are adequate to meet our present and foreseeable needs, subject to possible future expansion.

## ITEM 3. Legal Proceedings

We are not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Periodically, there have been claims involving Oconee Federal Savings and Loan Association, such as claims to enforce liens, condemnation proceedings on properties in which we hold a security interest, claims involving the making and servicing of real property loans and other issues incidental to our business.

At June 30, 2016, we were not involved in any legal proceedings the outcome of which would be material to our financial condition or results of operations.

## ITEM 4. Mine Safety Disclosures

Not applicable.

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## PART II

## ITEM 5.

## Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market. Our common stock is listed on the Nasdaq Capital Market under the symbol “OFED.” The approximate number of holders of record of our common stock as of September 19, 2016 was 357. Certain shares of our common stock are held in “nominee” or “street” name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

The following table sets forth, for the periods indicated, the high and low sales prices per share for the common stock as reported on the Nasdaq Capital Market and the cash dividends declared per common share, for the periods shown:

	High	Low	Dividends
Quarter ended June 30, 2016	\$ 20.75	\$ 18.53	\$ 0.10
Quarter ended March 31, 2016	\$ 20.49	\$ 18.21	\$ 0.10
Quarter ended December 31, 2015	\$ 20.00	\$ 17.95	\$ 0.10
Quarter ended September 30, 2015	\$ 20.00	\$ 17.01	\$ 0.10
Quarter ended June 30, 2015	\$ 20.95	\$ 18.00	\$ 0.10
Quarter ended March 31, 2015	\$ 21.50	\$ 19.01	\$ 0.10
Quarter ended December 31, 2014	\$ 21.00	\$ 18.35	\$ 0.10
Quarter ended September 30, 2014	\$ 18.83	\$ 17.00	\$ 0.10

Dividends. We are generally permitted to pay dividends on our common stock if, after giving effect to the distribution, we would be able to pay our indebtedness as the indebtedness comes due in the usual course of business and our total assets exceed the sum of our liabilities and the amount needed, if we were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of any holders of capital stock who have a preference in the event of dissolution. The holders of our common stock are entitled to receive and share equally in dividends as may be declared by our board of directors out of funds legally available therefore. If we issue shares of preferred stock, the holders thereof may have a priority over the holders of our common stock with respect to dividends. The dividend rate and the continued payment of dividends will depend upon our board of directors’ consideration of a number of factors, including investment opportunities available to us, capital requirements, our financial condition and results of operations, and statutory and regulatory limitations, tax considerations and general economic conditions. There can be no assurance that our quarterly cash dividend will not be reduced or eliminated in future periods.

Dividend payments by Oconee Federal Financial Corp. are dependent primarily on dividends it receives from Oconee Federal Savings and Loan Association, because Oconee Federal Financial Corp. has no source of income other than dividends from Oconee Federal Savings and Loan Association, earnings from the investments by Oconee Federal Financial Corp. and interest payments with respect to its loan to the Employee Stock Ownership Plan. Oconee Federal Savings and Loan Association is not permitted to make a capital distribution if, after making such distribution, it would be undercapitalized. In addition, if a banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements, it will be prohibited from making capital distributions. The capital conservation buffer requirement began being phased in on January 1, 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented at 2.5% on January 1, 2019. For information concerning additional federal laws and regulations regarding the ability of Oconee Federal Savings and Loan Association to make capital distributions, including the payment of dividends to Oconee Federal Financial Corp., see “Supervision and Regulation — Federal Banking Regulation” and “— Holding Company Regulation.”

When Oconee Federal Financial Corp. pays dividends on its common stock to public shareholders, it will also be required to pay dividends to Oconee Federal, MHC, unless Oconee Federal, MHC elects to, and is permitted to, waive the receipt of dividends. There can be no assurance that a dividend waiver request would be approved by the Federal Reserve Board.



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Equity Compensation Plans. At June 30, 2016, there were no compensation plans under which equity securities of Oconee Federal Financial Corp. were authorized for issuance other than the Employee Stock Ownership Plan and the Equity Incentive Plan. See “Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.”

Issuer Repurchases. On November 24, 2015, the Board of Directors authorized the repurchase of up to 175,000 shares of the Company’s common stock, terminating the previous authorization on June 19, 2013 to repurchase 150,000 shares. The repurchase authorization has no expiration date. In connection with this repurchase authorization, the Company has purchased a total of 154,532 shares of its common stock. During the three months ended June 30, 2016, the Company repurchased the following shares:

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Approximate Maximum Dollar Value or Number of Shares That May Yet be Purchased Under Publicly Announced Plan
April 1 – April 30, 2016	—	\$ —	—	157,325
May 1 – May 31, 2016	23,650	19.89	23,650(1)	133,675(2)
June 1 – June 30, 2016	9,907	20.20	9,907(1)	123,768(2)
Total	33,557	\$ 19.98	33,557	

(1)

All shares were purchased pursuant to a publicly announced repurchase program that was approved by the Board of Directors on November 24, 2015.

(2)

Represents the maximum number of shares available for repurchase under the November 24, 2015 plan at June 30, 2016.

Sales of Unregistered Securities. During the year ended June 30, 2016, we did not offer or sell any unregistered securities.

**ITEM 6.****Selected Financial Data**

	At or For the Year Ended June 30,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Financial condition data:					
Total assets	\$ 485,640	\$ 475,344	\$ 360,501	\$ 370,095	\$ 377,753
Investment securities	132,084	111,167	103,806	96,024	73,273
Loans receivable, net	291,141	308,259	229,931	221,163	249,832

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Deposits	399,634	394,093	281,015	292,422	293,368
Total equity	85,401	80,790	76,981	76,162	82,984
Operating data:					
Interest and dividend income	\$ 17,755	\$ 16,185	\$ 12,976	\$ 13,992	\$ 15,269
Interest expense	1,189	1,229	1,480	2,174	3,202
Net interest income	16,566	14,956	11,496	11,818	12,067
Provision for loan losses	451	195	108	260	270
Noninterest income	2,643	1,398	608	410	412
Noninterest expenses	11,480	8,957	6,307	5,496	5,624
Income before income taxes	7,278	7,202	5,689	6,472	6,585
Income taxes	2,032	2,690	2,050	2,432	2,572
Net income	\$ 5,246	\$ 4,512	\$ 3,639	\$ 4,040	\$ 4,013
Basic net income per share	\$ 0.91	\$ 0.79	\$ 0.64	\$ 0.67	\$ 0.66
Diluted net income per share	\$ 0.90	\$ 0.78	\$ 0.64	\$ 0.67	\$ 0.65

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	For the Years Ended June 30,				
	2016	2015	2014	2013	2012
Performance ratios:					
Return on average assets	1.09%	1.04%	1.00%	1.08%	1.07%
Return on average equity	6.31	5.64	4.78	5.00	4.89
Interest rate spread(1)	3.72	3.66	3.20	3.10	3.26
Net interest margin(2)	3.77	3.73	3.30	3.25	3.31
Noninterest expense to average assets	2.39	2.07	1.74	1.46	1.49
Efficiency ratio(3)	60.16	55.33	53.13	45.44	45.07
Average interest-earning assets to average interest-bearing liabilities	1.18x	1.20x	1.24x	1.26x	1.27x
End of year equity to average assets	17.78%	18.61%	21.22%	20.30%	22.05%
Average equity to average assets	17.29	18.44	20.98	21.54	21.79
Capital ratios:					
Total capital to risk weighted assets	31.00%	32.28%	42.31%	44.29%	45.25%
Common equity tier 1 capital to risk weighted assets	30.59	31.82	N/A	N/A	N/A
Tier I capital to risk weighted assets	30.59	31.82	41.73	43.83	44.74
Tier I capital to adjusted total assets	15.40	15.39	19.61	19.62	19.94
Asset quality ratios:					
Allowance for loan losses as a percentage of total loans	0.31%	0.32%	0.37%	0.34%	0.34%
Allowance for loan losses as a percentage of nonperforming loans	24.54	24.13	51.91	37.81	37.23
Allowance for loan losses as a percentage of nonperforming assets	18.04	16.08	35.76	24.76	27.15
Net charge-offs to average outstanding loans during the period	0.18	0.01	0.00	0.16	0.06
Nonperforming loans as a percentage of total loans	1.28	1.35	0.71	0.89	0.91
Nonperforming assets as a percentage of total assets	1.05	1.32	0.66	0.82	0.84
Nonperforming assets as a percentage of loans and real estate owned	1.74	2.01	1.03	1.35	1.25
Other:					
Number of full-service branch offices	7	7	4	4	4

(1)

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

(2)



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

(3)

Represents noninterest expense divided by the sum of net interest income and noninterest income, excluding gains or losses on the sale of securities.

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ITEM 7.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Oconee Federal Savings and Loan Association has historically operated as a traditional thrift institution headquartered in Seneca, South Carolina. Our principal business consists of attracting retail deposits from the general public in our market area and investing those deposits, together with funds generated from operations, in one-to-four family residential mortgage loans and, to a much lesser extent, nonresidential mortgage, construction and land and other loans. We also invest in U.S. Government and federal agency securities and mortgage-backed securities. Our revenues are derived principally from the interest on loans and securities and loan fees and service charges. Our primary sources of funds are deposits and principal and interest payments on loans and securities. At June 30, 2016, we had total assets of \$485.6 million, total deposits of \$399.6 million and total equity of \$85.4 million.

A significant majority of our assets consist of long-term, fixed-rate residential mortgage loans and, to a much lesser extent, investment-quality securities, which we have funded primarily with deposit accounts and the repayment of existing loans. We generally do not rely on outside borrowings. Our results of operations depend primarily on our net interest income. Net interest income is the difference between the interest income we earn on our interest-earning assets, consisting primarily of loans, investment securities (including U.S. Government and federal agency securities and mortgage-backed securities) and other interest-earning assets, primarily interest-earning deposits at other financial institutions, and the interest paid on our interest-bearing liabilities, consisting primarily of savings and transaction accounts and certificates of deposit. Our results of operations also are affected by our provisions for loan losses, noninterest income and noninterest expense. Noninterest income currently consists primarily of service charges on deposit accounts and miscellaneous other income. Noninterest expense currently consists primarily of compensation and employee benefits, occupancy and equipment expenses, data processing, professional and supervisory fees, office expense, provision for real estate owned and related expenses, and other operating expenses. Our results of operations also may be affected significantly by general and local economic and competitive conditions, changes in market interest rates, governmental policies and actions of regulatory authorities.

Other than our loans for the construction of one-to-four family residential mortgage loans, we do not offer "interest only" mortgage loans on one-to-four family residential properties (where the borrower pays interest for an initial period, after which the loan converts to a fully amortizing loan). We also do not offer loans that provide for negative amortization of principal, such as "Option ARM" loans, where the borrower can pay less than the interest owed on his or her loan, resulting in an increased principal balance during the life of the loan. We do not offer "subprime loans" (loans that generally target borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios) or Alt-A loans (generally defined as loans having less than full documentation).

Our securities are typically high-quality securities issued or guaranteed by the U.S. government or by Freddie Mac, Fannie Mae or Ginnie Mae, all of which are U.S. government-sponsored enterprises.

Critical Accounting Policies

We consider accounting policies that require management to exercise significant judgment or discretion or make significant assumptions that have, or could have, a material impact on the carrying value of certain assets or on income, to be critical accounting policies. Additional discussions of these policies are discussed in Note 1 "Summary of Significant Accounting Policies" to the accompanying Consolidated Financial Statements contained in Item 8. We consider the following to be our critical accounting policies:

Allowance for Loan Losses. Our allowance for loan losses is the estimated amount considered necessary to reflect probable losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses, which is charged against income. In determining the allowance for loan losses, management makes significant estimates and judgments, which to some extent involve assumptions about borrowers' abilities to continue to make future principal and interest payments. These estimates and judgments involve a high degree of judgment and subjectivity and are based on facts



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and circumstances that existed at the date in which the allowance is determined. Changes in the macro and micro economic environment can have a significant impact on these estimates and judgments in the future that could result in changes to the allowance for loan losses.

Integral to our allowance methodology is the use of a loan grading system whereby all loans are assigned a grade based on the risk profile of each loan. Loan grades are initially assigned at origination and are routinely evaluated to determine if grades need to be changed. Through our internal credit review function, ongoing credit monitoring, and continuous review of past due trends, loan grades are adjusted by management either to respond to improvements in or deterioration of credit. Loan grades are determined based on an evaluation of relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors.

The allowance methodology consists of two parts: an evaluation of loss for specific loans and an evaluation of loss for homogenous pools of loans, commonly referred to as the specific and general valuation allowance. Certain loans exhibiting signs of potential credit weakness are evaluated individually for impairment. A loan is considered to be impaired if it is probable that we will not receive substantially all contractual principal and interest payments. The amount of impairment, or specific valuation allowance, is measured by a comparison of the present value of expected future cash flows less selling expenses to the loan's carrying value, or in the case of collateral dependent loans a comparison to the fair value of the collateral less selling costs. To the extent the carrying value of the loan exceeds the present value of a loan's expected cash flows less selling expenses, a specific allowance is recorded. If the carrying value is less than the present value of the impaired loan's expected future cash flows, no specific allowance is recorded however the loan is not included in the determination of the general valuation allowance.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans and discounted cash flow valuations of properties are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisals and discounted cash flow valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals and discounted cash flow valuations are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans.

The general valuation allowance is determined for loans not determined to be impaired. We segregate our loan portfolio into portfolio segments. These portfolio segments share common characteristics such as the type of loan, its purpose, its underlying collateral, and other risk characteristics. Once segregated, these loans are further segregated by loan grade. To calculate the allowance by grade, we apply internally developed loss factors comprised of both quantitative and qualitative considerations.

We estimate our loss factors by taking into consideration both quantitative and qualitative aspects that would affect our estimation of probable incurred losses. These aspects include, but are not limited to historical charge-offs; loan delinquencies and foreclosure trends; current economic trends and demographic data within our market area, such as unemployment rates and population trends; current trends in real estate values; charge-off trends of other comparable institutions; the results of any internal loan reviews; loan-to-value ratios; our historically conservative credit risk policy; the strength of our underwriting and ongoing credit monitoring function; and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision based on changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses we have established, which could have a material negative effect on our financial results. See Note 1 "Summary of Significant Accounting Policies" and Note 5 "Loans" to the accompanying Consolidated Financial Statements contained in Item 8 for additional discussion on the allowance for loan losses.

**Business Combinations.** Business combinations are accounted for using the acquisition method of accounting. As such, assets acquired, including identified intangible assets, and liabilities assumed are recorded at their fair value, which often involves estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation techniques, all

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of which are inherently subjective. Identified intangible assets are amortized based upon the estimated economic benefits to be received, which is also subjective. Management will review identified intangible assets for impairment at least annually, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in which case an impairment charge would be recorded. Goodwill is subject to impairment testing on at least an annual basis. In addition, goodwill is tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Our reporting unit for purposes of testing our goodwill for impairment is our banking operations unit, which contains all other activities performed by the Company.

**Valuation of Goodwill.** The testing for impairment of goodwill is a two-step process. The first step in testing for impairment is to determine the fair value of our reporting unit and compare that fair value with the carrying value of the reporting unit (including goodwill.) If the fair value of the reporting unit exceeds the carrying value, the second step is not necessary and goodwill is deemed not to be impaired. If the fair value of the reporting unit is less than the carrying value, the Company must estimate a hypothetical purchase price for the reporting unit (representing the unit's fair value) and then compare that hypothetical purchase price with the fair value of the unit's net assets (excluding goodwill). Any excess of the estimated purchase price over the fair value of the reporting unit's net assets represents the implied fair value of goodwill. An impairment loss would be recognized as a charge to earnings if the carrying amount of the reporting unit's goodwill exceeds the implied fair value of goodwill. Our annual impairment evaluation is May of each year.

**Valuation of Assets Acquired in Business Combinations.** Assets acquired and liabilities assumed in business combinations are recorded at estimated fair value on their purchase date. As provided for under generally accepted accounting principles, management has up to 12 months following the date of the acquisition to finalize the fair values of acquired assets and assumed liabilities. Once management has finalized the fair values of acquired assets and assumed liabilities within this 12-month period, management considers such values to be the Day 1 Fair Values. For purchased loans, no allowance for loan loss is carried over from the acquired institution as all loans are recorded at fair value. In determining the Day 1 Fair Values of purchased loans, management considers a number of factors including, among other things, the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, estimated holding periods, and net present value of cash flows expected to be received.

Loans acquired with no evidence of credit deterioration at the date of purchase are recorded at their outstanding principal balances net of their relevant fair value premiums or discounts, forming the initial carrying value of those loans. These premiums or discounts are amortized into income over the life of the loans using the effective interest method. Income recognition on purchased credit impaired loans is based upon the cash flow method.

Under this method, the initial fair value discount on these loans is separated into two components, the accretable yield and nonaccretable difference. The accretable yield represents the excess of the expected future cash flows of these loans over the amount paid for these loans. The nonaccretable difference represents the excess of contractually required principal and interest payments over the expected cash flows to be received. These cash flow estimations are performed at the date of acquisition and form the basis for the determination of the fair value of these loans.

Periodically, management reevaluates the expected future cash flows of purchased credit impaired loans and adjusts for increases to or decreases from the previous period's expectations. Increases in future expected cash flows of a purchased credit impaired loan will result in a reversal of any allowance previously allocated with the difference increasing the accretable yield. Decreases result in an additional provision for loan loss to account for the impairment of the loan. Gains on dispositions are recognized on PCI loan prepayments and payoffs that are not anticipated and, therefore, are not accounted for as yield adjustments. Because these gains are significantly affected by PCI loan payments and payoffs, this income item may vary significantly from period to period.

**Deferred Income Taxes.** We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to

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apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change.

**Real Estate Owned Valuation.** Real estate acquired through loan foreclosure is carried at the lower of carrying amount or fair value less estimated costs to sell. Any initial losses at the time of foreclosure are charged against the allowance for loan losses. Valuation of these assets are periodically reviewed by management with the carrying value of such assets adjusted through noninterest expense to the then estimated fair value, net of estimated selling costs, if lower, until disposition. Fair values of real estate owned are generally based on third party appraisals or other valuations of the property.

**Business Strategy**

We have continued our primarily focus on the execution of our community oriented retail banking strategy. Highlights of our current business strategy include the following:

- **Continue to Focus on Residential Lending.** We have been and will continue to be primarily a one-to-four family residential mortgage lender for borrowers in our market area. As of June 30, 2016, \$248.5 million, or 84.8%, of our total loan portfolio consisted of one-to-four family residential mortgage loans (including home equity loans). In the future, we may gradually increase our residential construction and home equity loan portfolios.

- **Maintain a Modest Portfolio of Nonresidential Real Estate Loans.** We have historically maintained a small portfolio of nonresidential real estate loans, primarily loans to churches located in our market area. However, as a result of the acquisition of Stephens Federal, our nonresidential real estate loans have increased and were \$20.3 million, or 6.9% of our total loan portfolio at June 30, 2016. Of the \$20.3 million of nonresidential real estate loans, \$9.4 million were loans to churches. We plan to increase our efforts toward more nonresidential real estate lending in the future in an effort to increase our loan portfolio yields and to better manage our interest rate risk.

- **Manage Interest Rate Risk While Maintaining or Enhancing, to the Extent Practicable, our Net Interest Margin.** Subject to market conditions, we have sought to enhance net interest income by emphasizing controls on the cost of funds, particularly on the deposit products that we offer, rather than attempting to maximize asset yields, as loans with high yields often involve greater credit risk and may be repaid during periods of decreasing market interest rates. In addition, in view of our strong capital position, from time to time, we place more emphasis on enhancing our net interest income than on limiting our interest rate risk.

- **Rely on Community Orientation and High Quality Service to Maintain and Build a Loyal Local Customer Base and Maintain our Status as an Independent Community-Based Institution.** We were established in 1924 and have been operating continuously in Oconee County since that time. By using our recognized brand name and the goodwill developed over years of providing timely, efficient banking services, we have been able to attract a solid base of local retail customers on which to continue to build our banking business. We have historically focused on promoting relationships within our community rather than specific banking products, and we expect to continue to build our customer base by relying on customer referrals and referrals from local builders and realtors. We intend to extend this strategy to the Rabun and Stephens counties as well.

- **Adhere to Conservative Underwriting Guidelines to Maintain Strong Asset Quality.** We have emphasized maintaining strong asset quality by following conservative underwriting guidelines, sound loan administration, and focusing on loans secured by real estate located within our market area only. Our nonperforming assets totaled \$5.1 million, or 1.1% of total assets at June 30, 2016. Our total nonperforming loans to total loans ratio was 1.3% at

June 30, 2016. Total loan delinquencies, 30 days or more past due, as of June 30, 2016, were \$10.3 million, or 3.5% of total loans. The acquisition of Stephens Federal resulted in increases to nonperforming assets and delinquencies compared to periods prior to the acquisition; however, these have subsequently declined.

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### Comparison of Financial Condition at June 30, 2016 and June 30, 2015

Our total assets increased by \$10.3 million, or 2.2%, to \$485.6 million at June 30, 2016 from \$475.3 million at June 30, 2015. Increases in deposits and funds from loan repayments were invested in securities available-for-sale and bank-owned life insurance. Securities available-for-sale increased \$20.9 million from June 30, 2015 to June 30, 2016. Total gross loans decreased to \$292.1 million at June 30, 2016 from \$309.3 million at June 30, 2015. The decrease in loans was primarily due to lower demand during this period of slow economic recovery. The majority of the decrease was in our one-to-four family loans, which decreased by \$14.2 million, or 5.5%, to \$242.1 million at June 30, 2016 from \$256.3 million at June 30, 2015. During September 2015 we purchased an additional \$8.0 million of bank owned life insurance.

Our total deposits increased to \$399.6 million at June 30, 2016 from \$394.1 million at June 30, 2015. The sustained low interest rate environment has prompted many depositors to move their funds to the market seeking higher yielding investments. We generally do not accept brokered deposits and no brokered deposits were accepted during the year ended June 30, 2016.

Our total cash and deposit balance includes the deposits of Oconee Federal, MHC.

We had no advances from the Federal Home Loan Bank of Atlanta as of June 30, 2016 and 2015. We had credit available under a loan agreement with the Federal Home Loan Bank of Atlanta in the amount of 11% of total assets, or approximately \$53.2 million at June 30, 2016. This amount increased to 25% of total assets or \$121.4 million subsequent to June 30, 2016 due to the new credit policies of the Federal Home Loan Bank of Atlanta.

Our total stockholders' equity increased \$4.6 million to \$85.4 million at June 30, 2016 from \$80.8 million at June 30, 2015. The increase is primarily the result of net income for the year ended June 30, 2016 of \$5.2 million; an increase in unrealized gains on our available-for-sale securities of \$1.8 million, which is included net of tax in accumulated other comprehensive income; and the approximate \$290 thousand reduction in the unearned ESOP balance and recognition of compensation expense associated with our equity incentive plans, which both increased equity. These increases to equity were offset by dividend payments of \$2.3 million and the repurchases of 51,232 shares of stock for \$1.0 million.

### Comparison of Operating Results for the Years Ended June 30, 2016 and June 30, 2015

**General.** Net income increased by \$734 thousand, or 16.3%, to \$5.2 million for the year ended June 30, 2016 from \$4.5 million for the year ended June 30, 2015. The increase in net income was the result of an increase in net interest income before the provision for loan losses of \$1.6 million, or 10.8%, to \$16.6 million for the year ended June 30, 2016 from \$15.0 million for the year ended June 30, 2015 and an increase in noninterest income of \$1.2 million, or 89.1%, to \$2.6 million from \$1.4 million. The increase to noninterest income is primarily attributable to gains on the disposition of purchase credit impaired loans which amounted to \$1.1 million for the year ended June 30, 2016 compared to \$256 thousand for the prior year. These increases were offset partially by an increase in noninterest expense of \$2.5 million, or 28.2%, to \$11.5 million for the year ended June 30, 2016 from \$9.0 million for the year ended June 30, 2015. Most of this increase relates to the recognition of a full year of personnel and occupancy costs from the Stephens Federal acquisition. Tax expense decreased from \$2.7 million for the year ended June 30, 2015 to \$2.0 million for the year ended June 30, 2016.

**Interest Income.** Interest income increased by \$1.6 million, or 9.7%, to \$17.8 million for the year ended June 30, 2016 from \$16.2 million for the year ended June 30, 2015. The increase was the result of both an increase in the average balance of interest-earning assets and a slight increase in the average yield on these assets during the year ended June 30, 2016 as compared to the year ended June 30, 2015. The average balance of interest-earning assets increased to \$439.2 million for the year ended June 30, 2016 from \$401.2 million for the year ended June 30, 2015. The average yield on interest-earning assets increased to 4.04% for the year ended June 30, 2016 from 4.03% for the year ended June 30, 2015.

Interest income on loans increased \$973 thousand, or 6.8%, to \$15.4 million for the year ended June 30, 2016 from \$14.4 million for the year ended June 30, 2015. Both volume and rate contributed to the increase. The average balance of our loans increased to \$297.9 million for the year ended June 30, 2016 from \$285.2 million for the year ended June 30, 2015. The average yield was 5.16% for the year ended June 30, 2016 compared to 5.05% for the year ended June 30, 2015.





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Interest income on investment securities increased \$528 thousand, or 30.6%, to \$2.3 million for the year ended June 30, 2016 from \$1.7 million for the year ended June 30, 2015, reflecting an increase of \$18.5 million, or 18.0%, in the average balances of securities to \$121.5 million from \$103.0 million for the years ended June 30, 2016 and 2015 and an increase in the total average yield of our investment securities of 18 basis points to 1.85% from 1.67%. The increase in average balances of our investment securities is reflective of our efforts to continue to invest excess cash liquidity in high-quality investment securities during this period of low loan demand. Additionally, we continue to shift more of our investment portfolio into high-quality, higher yielding municipal securities, which helps to reduce our overall tax liability.

**Interest Expense.** Interest expense remained flat at \$1.2 million for the years ended June 30, 2016 and 2015. The average rate paid on deposits decreased five basis points in fiscal year 2016 to 0.32% from 0.37% for fiscal year 2015. The decrease in the average rate paid on deposits was offset by the increase in the average balance of deposits of \$37.8 million, or 11.3%, to \$373.2 million for the year ended June 30, 2016 from \$335.5 million for the year ended June 30, 2015.

Interest expense on money market deposits increased \$170 thousand as the cost of these deposits increased 24 basis points from 0.17% for the year ended June 30, 2015 to 0.41% for the year ended June 30, 2016. The average balance of money market deposits increased from \$14.9 million to \$47.6 million for the same period. The increases resulted from a successful money market campaign during the year ended June 30, 2016.

Interest expense on NOW and demand deposits and regular savings and other deposits decreased by \$71 thousand to \$68 thousand for the year ended June 30, 2016 from \$139 thousand for the year ended June 30, 2015. The decrease in interest expense on these deposits was largely attributable to the decrease in the cost on these deposits. The total average cost on these deposits decreased nine basis points to 0.08% from 0.17%.

Interest expense on certificates of deposit decreased \$139 thousand, or 13.1%, to \$926 thousand for the year ended June 30, 2016 from \$1.1 million for the year ended June 30, 2015. The decrease in interest expense on certificates of deposits primarily reflected a decrease of six basis points in the average cost on certificates of deposit to 0.39% from 0.45%. The average balance of certificates of deposits also decreased to \$236.3 million for the year ended June 30, 2016 from \$238.1 million for the year ended June 30, 2015.

**Net Interest Income.** Net interest income increased by \$1.6 million, or 10.8%, to \$16.6 million for the year ended June 30, 2016 compared to \$15.0 million for 2015. Net interest margin for the year ended June 30, 2016 was 3.77%, up four basis points from 3.73% for the year ended June 30, 2015. This increase in net interest margin was reflective of the decrease in our average cost of funds to 0.32% for the year ended June 30, 2016 from 0.37% for the year ended June 30, 2015 and a slight increase in the average yield on interest-earning assets to 4.04% for the year ended June 30, 2016 from 4.03% for the year ended June 30, 2015.

**Provision for Loan Losses.** We recorded a provision for loan losses of \$451 thousand for the year ended June 30, 2016 compared with a provision of \$195 thousand for the year ended June 30, 2015. Net charge-offs for the year ended June 30, 2016 were \$537 thousand and consisted of \$371 thousand on acquired loans and \$166 thousand on originated loans. Net charge-offs for the year ended June 30, 2015 were \$42 thousand.

Both the general and the specific valuation allowances decreased from June 30, 2015 to June 30, 2016; however the allowance as a percentage of total loans only decreased by one basis point, from 0.32% to 0.31%, respectively. Both the general and specific valuation allowances for the portfolio declined as a result of the decline in the average balance outstanding of portfolio loans and charge-offs on previously allocated impaired loans.

At June 30, 2016, all impaired loans were within our acquired loan portfolio and totaled \$5.4 million, \$4.4 million of which were purchased credit impaired. The remaining \$1.0 million of impaired loans were identified as having evidence of credit deterioration not existing at the acquisition date. The amount of impairment measured on these loans was \$55 thousand. Within our originated portfolio, there were no loans identified as impaired at June 30, 2016. At June 30, 2015, within our acquired loan portfolio, we had a total of \$7.9 million in impaired loans, \$7.4 million of which were purchased credit impaired. The remaining \$546 thousand of impaired loans were identified as having evidence of credit deterioration not

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existing at the acquisition date. The amount of impairment measured on these loans was \$89 thousand. Within our originated portfolio, we had \$2.1 million in impaired loans, and the impairment amount on these loans was \$115 thousand. During 2016 we changed our policy to only identify specific impairment on loans over \$250 thousand. All smaller, homogenous loans are evaluated on a pool basis as of June 30, 2016.

Our ratio of nonperforming loans to total loans decreased to 1.3% at June 30, 2016 from 1.4% at June 30, 2015, and our ratio of nonperforming assets to total assets decreased to 1.1% from 1.3% at the same dates. Total nonperforming loans was \$3.8 million at June 30, 2016 compared to \$4.2 million at June 30, 2015. A total of \$731 thousand of nonperforming loans was related to our originated portfolio and \$3.0 million was related to our acquired loan portfolio. Of the \$3.0 million in nonperforming loans within our acquired portfolio, \$1.6 million are loans identified as purchased credit impaired. At June 30, 2015, a total of \$1.0 million of nonperforming loans was related to our originated portfolio and \$3.2 million was related to our acquired loan portfolio. Of the \$3.2 million in nonperforming loans within our acquired portfolio, \$2.8 million are loans identified as purchased credit impaired.

We used the same methodology in assessing the allowances for both periods ended. Our allowance at June 30, 2016 reflects both a general valuation component of \$738 thousand and a specific component of \$184 thousand for loans determined to be impaired based upon an analysis of certain individual loans determined to be impaired. In comparison, our allowance at June 30, 2015 consisted of a general valuation component of \$788 thousand and a specific component of \$220 thousand. Overall, our allowance for loan losses to the total gross carrying value of loans remained level at 0.32% for both years. To the best of our knowledge, we have recorded all losses that are both probable and reasonably estimable for the years ended June 30, 2016 and 2015.

**Noninterest Income.** For the year ended June 30, 2016, noninterest income increased \$1.2 million, or 89.1%, to \$2.6 million from \$1.4 million for the year ended June 30, 2015. The significant portion of the increase relates to gains on the disposition of purchase credit impaired loans which totaled \$1.1 million for the year ended June 30, 2016 compared to \$256 thousand for the year ended June 30, 2015. The increase also included increased income on bank owned life insurance and an increase in service charges on deposit accounts for the year ended June 30, 2016. Income from bank owned life insurance increased \$228 thousand as a result of the additional investment. Service charges on deposit accounts increased by \$138 thousand, or 42.7%, to \$461 thousand for the year ended June 30, 2016 from \$323 thousand for the year ended June 30, 2015.

**Noninterest Expense.** Noninterest expense increased \$2.5 million, or 28.2%, to \$11.5 million for the year ended June 30, 2016 from \$9.0 million for the year ended June 30, 2015. The increase in noninterest expenses was reflective of increases in salaries and employee benefits of \$1.3 million, or 24.1%, to \$6.6 million for the year ended June 30, 2016 from \$5.3 million for the year ended June 30, 2015 and increases in occupancy and equipment expenses to \$1.5 million for the year ended June 30, 2016 from \$1.1 million for the year ended June 30, 2015. The increases in salaries and employee benefits resulted from the increase of approximately 45 additional employees from the Stephens Federal acquisition. The increase in occupancy and equipment expenses reflects the increase in maintenance costs and depreciation expense associated with three additional branches and their furnishings and equipment from the acquisition.

When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value. These servicing rights are then measured at each reporting date and changes are recorded as “change in loan servicing asset” on the consolidated statements of income and comprehensive income. For the year ended June 30, 2016, we recognized an expense for the decrease in the loan servicing asset of \$350 thousand compared to recognizing income for the increase of \$27 thousand for the year ended June 30, 2015. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

**Income Tax Expense.** Income tax expense for the years ended June 30, 2016 and 2015 was \$2.0 million and \$2.7 million, respectively, with effective income tax rates of 27.9% and 37.4%, respectively. The decrease in our effective tax rate for the year ended June 30, 2016 is a result of management’s strategy to shift the investment portfolio into high-quality, higher-yielding municipal securities along with additional tax reducing strategies. The tax liability for June 30, 2015 included certain nondeductible acquisition related costs for income tax purposes that gave rise to permanent tax adjustments in determining income tax expense for book purposes. The total amount of nondeductible costs included in the calculation of income tax expense for the year ended June 30, 2015 was \$242 thousand.



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## Analysis of Net Interest Income

Net interest income represents the difference between the income we earn on interest-earning assets and the interest expense we pay on interest-bearing liabilities. Net interest income also depends upon the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rates earned or paid on them.

The following tables set forth average balance sheets, average yields and costs, and certain other information at the dates and for the periods indicated. All average balances are daily average balances. Nonaccrual loans were included in the computation of average balances, but have been reflected in the tables as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income.

	For the Year Ended June 30,								
	2016	Interest and Dividends	Yield/ Cost	2015	Interest and Dividends	Yield/ Cost	2014	Average Balance	Interest and Dividends
	(Dollars in Thousands)								
Assets:									
Interest-earning assets:									
Loans	\$ 297,928	\$ 15,378	5.16%	\$ 285,231	\$ 14,405	5.05%	\$ 224,295	\$ 11,3	
Investment securities	98,285	1,740	1.77	94,875	1,537	1.62	98,901	1,53	
Investment securities, tax-free	23,196	511	2.20	8,110	186	2.29	790	22	
Other interest-earning assets	19,751	126	0.64	13,004	57	0.44	23,951	54	
Total interest-earning assets	439,160	17,755	4.04	401,220	16,185	4.03	347,937	12,9	
Noninterest-earning assets	41,214			32,790			14,892		
Total assets	\$ 480,374			\$ 434,010			\$ 362,829		
Liabilities and equity:									
Interest-bearing liabilities:									
NOW and demand deposits	\$ 49,432	\$ 42	0.08%	\$ 36,707	\$ 36	0.10%	\$ 18,463	\$ 12	
Money market deposits	47,622	195	0.41	14,942	25	0.17	12,756	25	
Regular savings and other deposits	39,867	26	0.07	45,749	103	0.23	39,841	70	
Certificates of deposit	236,318	926	0.39	238,073	1,065	0.45	209,201	1,37	

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Total interest-bearing deposits	373,239	1,189	0.32	335,471	1,229	0.37	280,261	1,48
Total interest-bearing liabilities	373,239	1,189	0.32	335,471	1,229	0.37	280,261	1,48
Noninterest bearing deposits	22,242			17,988			4,910	
Other noninterest-bearing liabilities	1,817			536			1,531	
Total liabilities	397,298			353,995			286,702	
Equity	83,076			80,015			76,127	
Total liabilities and equity	\$ 480,374			\$ 434,010			\$ 362,829	
Net interest income		\$ 16,566			\$ 14,956			\$ 11,4
Interest rate spread			3.72%			3.66%		
Net interest margin			3.77%			3.73%		
Average interest-earning assets to average interest-bearing liabilities	1.18x			1.20x			1.24x	

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## Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for the major categories of our interest-earning assets and interest-bearing liabilities. Information is provided for each category of interest-earning assets and interest-bearing liabilities with respect to (i) changes attributable to changes in volume (i.e., changes in average balances multiplied by the prior-period average rate) and (ii) changes attributable to rate (i.e., changes in average rate multiplied by prior-period average balances). For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately to the change due to volume and the change due to rate.

	Year Ended June 30, 2016 Compared to 2015		
	Volume	Rate	Net
	(Dollars in thousands)		
Interest income:			
Loans	\$ 651	\$ 322	\$ 973
Investment securities	330	198	528
Other interest-earning assets	37	32	69
Total	1,018	552	1,570
Interest expense:			
Deposits	15	(55)	(40)
Total	15	(55)	(40)
Increase in net interest income	\$ 1,003	\$ 607	\$ 1,610

	Year Ended June 30, 2015 Compared to 2014		
	Volume	Rate	Net
	(Dollars in thousands)		
Interest income:			
Loans	\$ 3,077	\$ (37)	\$ 3,040
Investment securities	53	113	166
Other interest-earning assets	(3)	6	3
Total	3,127	82	3,209
Interest expense:			
Deposits	273	(524)	(251)
Total	273	(524)	(251)
Increase (decrease) in net interest income	\$ 2,854	\$ 606	\$ 3,460

## Management of Market Risk

Our most significant form of market risk is interest rate risk because, as a financial institution, the majority of our assets and liabilities are sensitive to changes in interest rates. Therefore, a principal part of our operations is to manage interest rate risk and limit the exposure of our net interest income to changes in market interest rates. Our board of directors is responsible for the review and oversight of our asset/liability strategies. The Asset/Liability Committee of our board of directors meets monthly and is charged with developing an asset/liability management plan. Our board of directors has established an Asset/Liability Management Committee, consisting of senior management, which communicates daily to review pricing and liquidity needs and to assess our interest rate risk. This committee is

responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate, given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by our board of directors.

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The techniques we are currently using to manage interest rate risk include:

- using pricing strategies in an effort to balance the proportions of 30-year and 15-year fixed rate loans in our portfolio;
- maintaining a modest portfolio of adjustable-rate one-to-four family residential loans;
- funding a portion of our operations with deposits with terms greater than one year;
- focusing our business operations on local retail customers who value our community orientation and personal service and who may be somewhat less sensitive to interest rate changes than wholesale deposit customers; and
- maintaining a strong capital position, which provides for a favorable level of interest-earning assets relative to interest-bearing liabilities.

Depending on market conditions, from time to time we place more emphasis on enhancing net interest margin rather than matching the interest rate sensitivity of our assets and liabilities. In particular, we believe that the increased net interest income resulting from a mismatch in the maturity of our assets and liabilities portfolios can, during periods of stable or declining interest rates, provide high enough returns to justify increased exposure to sudden and unexpected increases in interest rates. As a result of this philosophy, our results of operations and the economic value of our equity will remain vulnerable to increases in interest rates and to declines due to the difference between long- and short-term interest rates.

An important measure of interest rate risk is the amount by which the net present value (“NPV”) of an institution’s cash flows from assets, liabilities and off balance sheet items changes in the event of a range of assumed changes in market interest rates. We have prepared an analysis of estimated changes in our NPV under the assumed instantaneous changes in the United States treasury yield curve. The financial model uses a discounted cash flow analysis and an option-based pricing approach to measuring the interest rate sensitivity of the NPV. Set forth below is an analysis of the changes to the economic value of our equity as of June 30, 2016 in the event of designated changes in the United States treasury yield curve. At June 30, 2016, our NPV exposure related to these hypothetical changes in market interest rates was within the current guidelines we have established.

	Net Portfolio Value per Model	Dollar Change from Base	Percentage Change from Base	Percentage Total of Market Value of Assets
(Dollars in thousands)				
Up 300 basis points	\$ 114,469	\$ (2,413)	(2.06)%	(0.50)%
Up 200 basis points	116,651	(231)	(0.20)	(0.05)
Up 100 basis points	117,618	736	0.63	0.15
Base	116,882	—	—	—
Down 100 basis points	117,624	742	0.63	0.15

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurement. Modeling changes in net portfolio value requires making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the net portfolio value table presented assumes that the composition of our interest-sensitive assets and liabilities existing at the beginning of a

period remains constant over the period being measured and assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or repricing of specific assets and liabilities. In addition, the net portfolio value table does not reflect the impact of a change in interest rates on the credit quality of our assets. Accordingly, although the net portfolio value table provides an indication of our interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

Our policies generally do not permit us to engage in derivative transactions, such as futures, options, caps, floors or swap transactions; however, such transactions may be entered into with the prior approval of the Asset/Liability Management Committee or the board of directors for hedging purposes only.

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**Liquidity and Capital Resources**

Our primary sources of funds are deposits and the proceeds from principal and interest payments on loans and investment securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. We generally manage the pricing of our deposits to be competitive within our market and to increase core deposit relationships.

Our cash flows are derived from operating activities, investing activities and financing activities. Net cash flows provided by operating activities were \$8.1 million for the year ended June 30, 2016 and \$5.7 million for the year ended June 30, 2015. Net cash flows provided by operating activities consisted primarily of our net income. Net cash flows used in investing activities were (\$8.9) million for the year ended June 30, 2016 and consisted primarily of purchases of investment securities, offset by proceeds from maturities and paydowns on investment securities, net loan repayments, and an investment in bank owned life insurance. Net cash flows provided by investing activities for the year ended June 30, 2015 were \$37.0 million, which consisted of the net cash received of \$24.1 million from the acquisition of Stephens Federal and purchases of investment securities, offset by proceeds from maturities and paydowns on investment securities, and net loan repayments. Net cash flows provided by financing activities were \$2.3 million for the year ended June 30, 2016 and primarily consisted of increases in deposits offset by the payment of dividends and share repurchases of our common stock. Net cash flows used in financing activities were (\$28.4) million for the year ended June 30, 2015. Net cash flows used in financing activities consisted primarily of the payment of the net deposit outflow of (\$26.1) million for the year ended June 30, 2015 and the payments of dividends and share repurchases of our common stock.

Our most liquid assets are cash and short-term investments. The levels of these assets are dependent on our operating, financing, lending, and investing activities during any given period. At June 30, 2016 and 2015, cash and short-term investments totaled \$27.7 million and \$26.2 million, respectively. We may also utilize as sources of funds the sale of securities available-for-sale, federal funds purchased, Federal Home Loan Bank of Atlanta advances and other borrowings.

At June 30, 2016 and 2015, we had outstanding commitments to originate loans of \$2.9 million and \$662 thousand, respectively. We had \$15.3 in unfunded commitments under lines of credit at June 30, 2016 and \$7.9 in unfunded commitments under lines of credit at June 30, 2015. We anticipate that we will have sufficient funds available to meet our current loan commitments. In recent periods, loan commitments have been funded through liquidity and normal deposit flows. Certificates of deposit scheduled to mature in one year or less from June 30, 2016 totaled \$175.1 million. Management believes based on past experience that a significant portion of such deposits will remain with us. Based on the foregoing, in addition to our level of core deposits and capital, we consider our liquidity and capital resources sufficient to meet our outstanding short-term and long-term needs. Liquidity management is both a daily and long-term responsibility of management. We adjust our investments in liquid assets based upon management's assessment of expected loan demand, expected deposit flows, yields available on interest-earning deposits and investment securities, and the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest-earning overnight deposits and federal funds sold. If we require funds beyond our ability to generate them internally, we have additional borrowing capacity with the Federal Home Loan Bank of Atlanta. At June 30, 2016, we had an available borrowing limit of \$53.4 million in advances from the Federal Home Loan Bank of Atlanta which was subsequently increased to \$121.4 million.

We are subject to various regulatory capital requirements and at June 30, 2016, we were in compliance with all applicable capital requirements. See "Supervision and Regulation — Federal Banking Regulation — Capital Requirements" and Note 11 of the Notes to our Consolidated Financial Statements.

**Common Stock Dividend Policy.** The Company paid a quarterly \$0.10 per share dividend on August 27, 2015, November 27, 2015, February 25, 2016, and May 19, 2016 for a total of \$2.3 million in dividends paid during the year ended June 30, 2016. On July 28, 2016, the Board of Directors of the Company declared a quarterly cash dividend of \$0.10 per share of the Company's common stock payable to stockholders of record as of August 11, 2016, which was paid on August 25, 2016.

**Off-Balance Sheet Arrangements.** In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, are not



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recorded in our consolidated financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. For information about our loan commitments and unused lines of credit, see Note 10 of the Notes to our Consolidated Financial Statements.

For the fiscal year ended June 30, 2016, we did not engage in any off-balance-sheet transactions other than loan origination commitments in the normal course of our lending activities.

**Recent Accounting Pronouncements**

For a discussion of the impact of recent accounting pronouncements, see Note 1 of the Notes to our Consolidated Financial Statements.

**Impact of Inflation and Changing Prices**

The consolidated financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The primary impact of inflation on our operations is reflected in increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates, generally, have a more significant impact on a financial institution's performance than does inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

**ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk**

Quantitative and qualitative disclosures about market risk are not required for smaller reporting companies, such as the Company. However, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations — Management of Market Risk."

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ITEM 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Oconee Federal Financial Corp.

Seneca, South Carolina

We have audited the accompanying consolidated balance sheet of Oconee Federal Financial Corp. and Subsidiary (the “Company”) as of June 30, 2016, and the related consolidated statements of income and comprehensive income, changes in shareholders’ equity, and cash flows for the period ended June 30, 2016. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oconee Federal Financial Corp. and Subsidiary as of June 30, 2016, and the results of their operations and their cash flows for the year ended June 30, 2016, in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Horwath LLP

Atlanta, Georgia

September 28, 2016

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Oconee Federal Financial Corp.

Seneca, South Carolina

We have audited the accompanying consolidated balance sheets of Oconee Federal Financial Corp. and Subsidiary (the "Company") as of June 30, 2015, and the related consolidated statements of income and comprehensive income, shareholders' equity and cash flows for the year then ended. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oconee Federal Financial Corp. and Subsidiary as of June 30, 2015, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Cherry Bekaert LLP

Greenville, South Carolina

September 28, 2015

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OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2016 AND 2015

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

	June 30, 2016	June 30, 2015
<b>ASSETS</b>		
Cash and due from banks	\$ 4,874	\$ 4,883
Interest-earning deposits	22,802	21,309
Total cash and cash equivalents	27,676	26,192
Securities available-for-sale	132,084	111,167
Loans	292,063	309,267
Allowance for loan losses	(922)	(1,008)
Net loans	291,141	308,259
Loans held for sale, at fair value	129	118
Premises and equipment, net	6,811	7,058
Real estate owned, net	1,354	2,092
Accrued interest receivable		
Loans	1,016	1,077
Investments	492	312
Restricted equity securities, at cost	1,021	440
Bank owned life insurance	17,558	9,044
Goodwill	2,593	2,593
Core deposit intangible	744	874
Loan servicing rights	1,046	1,396
Deferred tax assets	1,128	3,766
Other assets	847	956
Total assets	\$ 485,640	\$ 475,344
<b>LIABILITIES</b>		
Deposits		
Noninterest bearing	\$ 23,356	\$ 20,254
Interest bearing	376,278	373,839
Total deposits	399,634	394,093
Accrued interest payable and other liabilities	605	461
Total liabilities	400,239	394,554
<b>SHAREHOLDERS' EQUITY</b>		
Common stock, \$0.01 par value, 100,000,000 shares authorized; 5,837,908 and 5,882,140 shares outstanding, respectively	65	65
Treasury stock, at par, 634,131 and 589,899 shares, respectively	(6)	(6)
Additional paid-in capital	12,882	13,354
Retained earnings	71,909	68,950

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Accumulated other comprehensive income (loss)	1,808	(26)
Unearned ESOP shares	(1,257)	(1,547)
Total shareholders' equity	85,401	80,790
Total liabilities and shareholders' equity	\$ 485,640	\$ 475,344

See accompanying notes to consolidated financial statements

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OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

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

	Years Ended	
	June 30, 2016	June 30, 2015
Interest and dividend income:		
Loans, including fees	\$ 15,378	\$ 14,405
Securities, taxable	1,740	1,537
Securities, tax-exempt	511	186
Interest-bearing deposits and other	126	57
Total interest income	17,755	16,185
Interest expense:		
Deposits	1,189	1,229
Total interest expense	1,189	1,229
Net interest income	16,566	14,956
Provision for loan losses	451	195
Net interest income after provision for loan losses	16,115	14,761
Noninterest income:		
Service charges on deposit accounts	461	323
Income on bank owned life insurance	514	286
Mortgage banking income	373	351
Gain on sales of securities	128	149
Gain on disposition of purchase credit impaired loans	1,119	256
Other	48	33
Total noninterest income	2,643	1,398
Noninterest expense:		
Salaries and employee benefits	6,550	5,277
Occupancy and equipment	1,512	1,060
Data processing	518	424
Professional and supervisory fees	940	830
Office expense	223	243
Advertising	204	98
FDIC deposit insurance	219	220
Foreclosed assets, net	288	313
Change in loan servicing asset	350	(27)
Other	676	519
Total noninterest expense	11,480	8,957
Income before income taxes	7,278	7,202
Income tax expense	2,032	2,690

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Net income	\$ 5,246	\$ 4,512
Other comprehensive income		
Unrealized gain on securities available-for-sale	\$ 2,995	\$ 348
Tax effect	(1,079)	(134)
Reclassification adjustment for gains realized in net income	(128)	(149)
Tax effect	46	56
Total other comprehensive income	1,834	121
Comprehensive income	\$ 7,080	\$ 4,633
Basic net income per share: (Note 3)	\$ 0.91	\$ 0.79
Diluted net income per share: (Note 3)	\$ 0.90	\$ 0.78
Dividends declared per share:	\$ 0.40	\$ 0.40
See accompanying notes to consolidated financial statements		

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## OCONEE FEDERAL FINANCIAL CORP.

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

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

	Common Stock	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Unearned ESOP Shares	Total
Balance at June 30, 2014	\$ 64	\$ (6)	\$ 12,186	\$ 66,705	\$ (147)	\$ (1,821)	\$ 76,981
Net income	—	—	—	4,512	—	—	4,512
Other comprehensive income	—	—	—	—	121	—	121
Purchase of 1,800 shares of treasury stock(1)	—	—	(35)	—	—	—	(35)
Issuance of 12,600 shares of restricted stock(2)	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	278	—	—	—	278
Common stock issued, 36,945 shares(3)	1	—	699	—	—	—	700
Dividends(4)	—	—	25	(2,267)	—	—	(2,242)
ESOP shares earned(4)	—	—	201	—	—	274	475
Balance at June 30, 2015	\$ 65	\$ (6)	\$ 13,354	\$ 68,950	\$ (26)	\$ (1,547)	\$ 80,790
Net income	—	—	—	5,246	—	—	5,246
Other comprehensive income	—	—	—	—	1,834	—	1,834
Purchase of 51,232 shares of treasury stock(5)	—	—	(1,013)	—	—	—	(1,013)
Issuance of 7,000 shares of restricted stock(6)	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	288	—	—	—	288
Dividends(7)	—	—	35	(2,287)	—	—	(2,252)

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ESOP shares earned(7)	—	—	218	—	—	290	508
Balance at June 30, 2016	\$ 65	\$ (6)	\$ 12,882	\$ 71,909	\$ 1,808	\$ (1,257)	\$ 85,401

(1)

The weighted average cost of treasury shares purchased during the year ended was \$19.81 per share. Treasury stock repurchases were accounted for using the par value method.

(2)

On January 25, 2015, the Company granted 12,600 shares of restricted stock. The grant date fair value of these shares was \$20.01.

(3)

36,945 shares issued to Oconee MHC at approximately \$18.95 per share for the acquisition of Stephens Federal Bank.

(4)

Approximately \$99 of cash dividends paid on shares in the ESOP was used as additional principal reduction on the ESOP debt, resulting in the release of approximately 7,889 additional shares. The portion of the dividend paid on allocated shares of approximately \$25 was treated as a dividend. The remaining portion of the dividend payment and resulting release of approximately 7,889 shares was accounted for as additional compensation expense of approximately \$74 for the year ended June 30, 2015.

(5)

The weighted average cost of treasury shares purchased during the year ended was \$19.77 per share. Treasury stock repurchases were accounted for using the par value method.

(6)

On February 5, 2016, the Company granted 7,000 shares of restricted stock. The grant date fair value of these shares was \$19.40.

(7)

Approximately \$99 of cash dividends paid on shares in the ESOP was used as additional principal reduction on the ESOP debt, resulting in the release of approximately 7,891 additional shares. The portion of the dividend paid on allocated shares of approximately \$35 was treated as a dividend. The remaining portion of the dividend payment and resulting release of approximately 7,891 shares was accounted for as additional compensation expense of approximately \$64 for the year ended June 30, 2016.

See accompanying notes to consolidated financial statements

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OCONEE FEDERAL FINANCIAL CORP.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015  
(Amounts in thousands, except share and per share data)

	Years Ended	
	June 30, 2016	June 30, 2015
Cash Flows From Operating Activities		
Net income	\$ 5,246	\$ 4,512
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	451	195
Provision for real estate owned	193	196
Depreciation and amortization, net	1,269	1,075
Net accretion of purchase accounting adjustments	(136)	(352)
Deferred income tax expense	1,605	1,923
Net loss on sale of real estate owned	14	6
Change in loan servicing asset	350	(27)
Gain on sales of securities	(128)	(149)
Mortgage loans originated for sale	(4,282)	(4,669)
Mortgage loans sold	4,304	4,978
(Gain) loss on sales of mortgage loans	(33)	145
Increase in cash surrender value of bank owned life insurance	(514)	(286)
Gain on disposition of purchased credit impaired loans	(1,119)	(256)
ESOP compensation expense	508	475
Stock based compensation expense	288	278
Net change in operating assets and liabilities:		
Accrued interest receivable and other assets	(10)	(709)
Accrued interest payable and other liabilities	144	(1,604)
Net cash provided by operating activities	8,150	5,731
Cash Flows From Investing Activities		
Net cash received from acquisition of Stephens Federal	—	24,079
Purchases of premises and equipment	(204)	(435)
Purchases of securities available-for-sale	(51,983)	(38,274)
Proceeds from maturities, paydowns and calls of securities available-for-sale	26,469	21,027
Proceeds from sales of securities available-for-sale	6,904	11,174
Purchases of restricted equity securities	(588)	—
Redemptions of restricted equity securities	7	27
Purchases of bank owned life insurance	(8,000)	—
Proceeds from sale of real estate owned	2,357	2,568
Dispositions of purchased credit impaired loans	2,587	1,197
Loan originations and repayments, net	13,509	15,621

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Net cash (used in) provided by investing activities	(8,942)	36,984
Cash Flows from Financing Activities		
Net change in deposits	5,541	(26,136)
Dividends paid	(2,252)	(2,242)
Purchase of treasury stock	(1,013)	(35)
Net cash provided by (used in) financing activities	2,276	(28,413)
Change in cash and cash equivalents	1,484	14,302
Cash and cash equivalents, beginning of year	26,192	11,890
Cash and cash equivalents, end of year	\$ 27,676	\$ 26,192

See accompanying notes to consolidated financial statements

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OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As of and for the Years Ended June 30, 2016 and 2015

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

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principle of Consolidation: The consolidated financial statements of Oconee Federal Financial Corp. include the accounts of its wholly owned subsidiary Oconee Federal Savings and Loan Association (the “Association”) (referred to herein as “the Company,” “we,” “us,” or “our”) and have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). Intercompany accounts and transactions are eliminated during consolidation. The Company is majority owned (71.33%) by Oconee Federal, MHC. These consolidated financial statements do not include the transactions and balances of Oconee Federal, MHC. The Association is a federally chartered stock savings and loan association engaged in the business of accepting savings and demand deposits and providing mortgage, consumer and commercial loans. On December 1, 2014, the Company completed its acquisition of Stephens Federal Bank. The consolidated financial statements include the results of operations of Stephens Federal Bank since the acquisition date. Primarily, the Association’s business is limited to the Oconee County area of northwestern South Carolina and the northeast area of Georgia in Stephens County and Rabun County. The following is a description of the significant accounting policies the Company follows in preparing and presenting its consolidated financial statements.

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

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

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank is required to meet regulatory reserve and clearing requirements. These balances do not earn interest.

Interest-Bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

Securities: Securities are classified as available-for-sale when they might be sold before maturity. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

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

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Loans held for sale, for which the fair value option has been elected, are recorded at fair value as of each balance sheet date. The fair value includes the servicing value of the loans as well as any accrued interest.

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

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method over the contractual lives of the loans without anticipating prepayments.

Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual.

Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

The allowance consists of specific and general components. The specific component consists of the amount of impairment related to loans that have been evaluated on an individual basis, and the general component consists of the amount of impairment related to loans that have been evaluated on a collective basis. Loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts when due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings ("TDRs").

Management utilizes an internal loan grading system and assigns each loan a grade of pass, special mention, substandard, and doubtful, which are more fully explained in Note 5. Any nonresidential or residential non-owner occupied loans that meet certain size requirements and performance characteristics are individually evaluated for impairment. The amount of impairment, if any, is measured by a comparison of the loan's carrying value to the net present value of future cash flows using the loan's effective rate at inception or at the fair value of collateral if repayment is expected to come solely from the collateral. All loans graded pass, special mention, substandard and doubtful not specifically evaluated for impairment are collectively evaluated for impairment by portfolio segment. To develop and document a systematic methodology for determining the portion of the allowance for loan losses for loans evaluated collectively, the Company has divided the loan portfolio into segments, each with different risk characteristics and methodologies for assessing risk. Those portfolio segments are discussed below:

One-to-four family: One-to-four family residential loans consist primarily of loans secured by first or second deeds of trust on primary residences, and are originated as adjustable-rate or fixed-rate loans for the

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OCONEE FEDERAL FINANCIAL CORP.

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

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. The Company currently originates residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes.

For traditional homes, the Company may originate loans with loan-to-value ratios in excess of 80% if the borrower obtains mortgage insurance or provides readily marketable collateral. The Company may make exceptions for special loan programs that we offer. For example, the Company currently offers mortgages with loan-to-value ratios of up to 95% to low- to moderate-income borrowers solely for the purchase of their primary residence. The Company also originates residential mortgage loans for non-owner-occupied homes with loan-to-value ratios of up to 80%.

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

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

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

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

**Nonresidential Real Estate:** Nonresidential loans include those secured by real estate mortgages on churches, owner-occupied and non-owner-occupied commercial buildings of various types, retail and office buildings, hotels, and other business and industrial properties. The nonresidential real estate loans that the Company originates generally have terms of 5 to 20 years with amortization periods up to 20 years. The maximum loan-to-value ratio of our nonresidential real estate loans is generally 75%.



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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company considers a number of factors in originating nonresidential real estate loans. The Company evaluates the qualifications and financial condition of the borrower, including credit history, cash flows, the applicable business plan, the financial resources of the borrower, the borrower's experience in owning or managing similar property and the borrower's payment history with the Company and other financial institutions. In evaluating the property securing the loan, the factors the Company considers include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service). For church loans, the Company also considers the length of time the church has been in existence, the size and financial strength of the denomination with which it is affiliated, attendance figures and growth projections and current and pro forma operating budgets. The collateral underlying all nonresidential real estate loans is appraised by outside independent appraisers approved by our board of directors. Personal guarantees may be obtained from the principals of nonresidential real estate borrowers, and in the case of church loans, guarantees from the applicable denomination may be obtained. Loans secured by nonresidential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Nonresidential real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. In addition, because a church's financial stability often depends on donations from congregation members, some of whom may not reside in our market area, rather than income from business operations, repayment may be affected by economic conditions that affect individuals located both in our market area and in other market areas with which we are not as familiar. In addition, due to the unique nature of church buildings and properties, the real estate securing church loans may be less marketable than other nonresidential real estate.

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

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

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



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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

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

**Concentration of Credit Risk and Other:** The Company’s business activity is principally with customers located in the northwest portion of South Carolina and northeast Georgia. The Company requires its customers to provide collateral, generally in the form of title to real estate, for substantially all loans. Certain consumer loans are made to customers without requiring collateral. Except for loans in the Company’s market area, the Company has no other significant concentrations of credit risk.

The Company places its cash and cash equivalents on deposit with financial institutions in the United States. The Federal Deposit Insurance Corporation (“FDIC”) provides deposit insurance for up to \$250,000 for substantially all depository accounts. The Company from time to time may have amounts on deposit in excess of the insured limits, and management believes the risk of loss is not significant.

**Purchased Credit Impaired Loans:** The Company has purchased individual loans, some of which have shown evidence of credit deterioration since origination. These purchased credit impaired (“PCI”) loans are recorded at the amount paid, such that there is no carryover of the seller’s allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses. Purchased credit impaired loans are accounted for individually. The Company estimates the amount and timing of expected cash flows for each loan, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loans’ contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).





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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Future expected cash flows are re-estimated periodically over the life of each purchased credit impaired loan. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income. Gains on dispositions are recognized on PCI loan prepayments and payoffs that are not anticipated and, therefore, are not accounted for as yield adjustments. Because these gains are significantly affected by PCI loan payments and payoffs, this income item may vary significantly from period to period.

**Purchased Performing Loans:** The Company accounts for purchased performing loans at acquisition at fair value, which includes a credit discount. The resulting fair value (premium/discount) is amortized/ accreted to interest income on a level yield basis over the estimated lives of the loans. There is no allowance for loan losses established for purchased performing loans at acquisition; however, a provision for loan losses is recorded for any further deterioration in these loans subsequent to the acquisition.

**Loan Servicing Rights:** When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in mortgaging banking income. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income.

Under the fair value measurement method, the Company measures servicing rights at fair value at each reporting date and reports changes in fair value of servicing assets in earnings in the period in which the changes occur, and are shown as change in loan servicing asset on the Consolidated Statements of Income and Comprehensive Income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

**Business Combinations:** The Company accounts for business combinations using the acquisition method, which requires that all assets acquired and liabilities assumed, including identified intangible assets and liabilities be recorded at their estimated fair values. The estimated fair values are subject to refinement for up to one year after the closing date of the acquisition as additional information regarding closing date fair value becomes available. During this one year period, the causes of any changes in cash flow estimates are considered to determine whether the change results from circumstances that existed at the acquisition date or if the change results from an event that occurred after the date of acquisition.

**Goodwill and Core Deposit Intangible:** Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Management reviews goodwill for impairment annually, or more frequently if deemed necessary, as goodwill is deemed to have an indefinite life. On the annual assessment date, May 31, management performs a qualitative assessment of whether it was more likely than not that the fair value exceeds carrying value. Based on the most recent assessment, management determined that it was more likely than not that the fair value exceeded its carrying value, resulting in no impairment to goodwill.

Core deposit intangibles represent the estimated value of long-term deposit core deposit relationships acquired in a business combination. This value is amortized over the weighted-average estimated useful lives of deposit accounts using a method that management believes reasonably approximates the anticipated benefit stream from this intangible. The estimated useful lives are periodically reviewed for reasonableness. The core deposit intangible acquired will be amortized over 15 years using the original projections of future benefit stream of cash flows, adjusted periodically, if needed for potential impairment of the remaining unamortized balance of the core deposit intangible. The fair value of the core deposit intangible at December 1, 2014 was \$959. Amortization expense of \$130 and \$85 was recognized for the years ended June 30, 2016 and 2015.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

with useful lives ranging from 5 to 39 years. Furniture, fixtures and equipment are depreciated using the straight-line method, with useful lives ranging from 5 to 7 years. Maintenance and repairs are charged to operations in the year incurred. Gains and losses on dispositions are included in current year operations. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable.

**Real Estate Owned:** Real estate acquired through loan foreclosure is initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, real estate owned is recorded at the lower of carrying amount or fair value less estimated costs to sell. Any initial losses at the time of foreclosure are charged against the allowance for loan losses with any subsequent losses or write-downs included in the consolidated statements of income and comprehensive income as a component of noninterest expenses.

**Restricted Equity Securities:** Restricted equity securities consist of Federal Home Loan Bank of Atlanta (“FHLB”) stock and First National Bankers Bancshares, Inc. (“FNBB”) stock. The Company is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. There is a very limited market for FNBB stock. Based on the redemptive provisions of the FHLB and FNBB, the stock is carried at cost, as restricted securities, and is periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

**Income Taxes:** The provision for income taxes is based on amounts reported in the consolidated statements of income and comprehensive income (after exclusion of non-taxable income such as interest on state and municipal securities) and includes changes in deferred taxes. Deferred taxes are computed using the asset and liability approach. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company follows guidance issued by the Financial Accounting Standards Board (“FASB”) with respect to accounting for uncertainty in income taxes. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in other noninterest expense.

**Comprehensive Income:** Comprehensive income consists of net income and other comprehensive income. Other comprehensive income for the Company consists solely of unrealized gains and losses on securities available-for-sale, net of tax.

**Loss Contingencies:** Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the consolidated financial statements.

**Loan Commitments and Related Financial Instruments:** Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

**Fair Value of Financial Instruments:** Fair values of financial instruments are estimated using relevant market information. Changes in market conditions could significantly affect the estimates. For financial instruments where there is little or no relevant market information due to limited or no market activity, the Company estimates the fair value of these instruments through the use of a discounted present value of estimated cash flows technique, which includes the Company's own assumptions as to the amounts and timing of cash flows, adjusted for risk factors related to nonperformance and liquidity. The Company's assumptions are based on an exit price strategy and take into consideration the assumptions that a willing market participant would use about nonperformance and liquidity risk.

**Employee Stock Ownership Plan:** The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of shareholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends, when paid, on allocated ESOP shares reduce retained earnings. Dividends, when paid, on unearned ESOP shares reduce debt and accrued interest.

**Retirement Plans:** Profit sharing plan expense is the amount of the Company's contribution to participants of the plan. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

**Bank Owned Life Insurance:** The Company has purchased life insurance policies on certain directors. Accounting guidance requires bank owned life insurance to be recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

**Reclassifications:** Some items in the prior year consolidated financial statements were reclassified to conform to the current presentation and had no effect on net income or shareholders' equity.

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

**Segment Reporting:** While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating results are not reviewed by senior management to make resource allocation or performance decisions. Management has determined that the Company has a single operating segment, which is to provide consumer and commercial banking services to individuals and businesses located in Oconee County, South Carolina and to Stephens and Rabun Counties, Georgia and their surrounding counties and townships. The Company's various products and services are those generally offered by community banks, and the allocation of resources is based on the overall performance of the Company versus individual regions, branches, products and services.

**New Accounting Standards:**

On January 5, 2016, the FASB issued Accounting Standards Update ("ASU") 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, to address certain aspects of recognition,

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

measurement, presentation, and disclosure of financial instruments. The ASU affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not believe that this new guidance will have a material effect on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, which establishes a right of use model that requires a lessee to record a right of use asset and a lease liability for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. A lease will be treated as sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, with certain practical expedients available. Early adoption is permitted. The Company does not believe that this new guidance will have a material effect on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation — Stock Compensation, which requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It also allows an employer to repurchase more of an employee's shares than it can today for tax withholding purposes without triggering liability accounting and to make a policy election for forfeitures as they occur. The guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted. The Company does not believe that this new guidance will have a material effect on the consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. On July 9, 2015, the FASB approved amendments deferring the effective date by one year. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In March and April 2016, the FASB issued final amendments (ASU 2016-08 and ASU 2016-10) to clarify the implementation guidance for principal versus agent considerations, identifying performance obligations and the accounting for licenses of intellectual property. In May 2016, the FASB issued final amendments (ASU-11) to clarify guidance related to collectability, noncash considerations, presentation of sales tax, and transition. The amendments can be applied retrospectively to each prior reporting period or retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. Early application is permitted but not before the original public entity effective date, i.e., annual periods beginning after December 15, 2016. The Company continues to assess the impact of ASU 2014-09 on its accounting and disclosures.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments — Credit Losses (Topic 326) — Measurement of Credit Losses on Financial Instruments. The provisions of ASU 2016-13 were issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity

at each reporting date. ASU 2016-13 requires that financial assets measured at amortized cost be presented at the net amount expected to be

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in ASU 2016-13 eliminate the probable incurred loss recognition in current GAAP and reflect an entity's current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination ("PCD assets") that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security.

ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of ASU 2016-13 on its accounting and disclosures.

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

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

NOTE 2 — ACQUISITION

On December 1, 2014, the Company and its parent company, Oconee Federal, MHC ("Oconee MHC"), completed the acquisition of Stephens Federal Bank ("Stephens Federal"). The acquisition was consummated in accordance with the Agreement and Plan of Merger by and among the Company, Oconee MHC, Oconee Federal and Stephens Federal dated February 26, 2014, as amended on May 6, 2014 (the "Merger Agreement"), pursuant to which Stephens Federal merged with and into the Association, with the Association as the surviving institution.

Pursuant to the terms of the Merger Agreement, Stephens Federal completed a voluntary supervisory conversion from a federally chartered mutual savings association to a federally chartered stock savings association immediately prior to the merger with the Association. Accordingly, no consideration was paid by the Association or the Company in connection with the acquisition of Stephens Federal; however, upon completion of the acquisition, the Company issued 36,945 shares of Company common stock to Oconee MHC, which is equal to the quotient of (i) the valuation of Stephens Federal, which was \$700, as determined by an independent third party, divided by (ii) the average closing price of the Company's common stock as reported on the NASDAQ for the 20 consecutive trading days ending on the third trading day preceding the effective date of the acquisition, or approximately \$18.95 per share.



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## NOTE 2 — ACQUISITION (Continued)

A summary of assets received and liabilities assumed for Stephens Federal, as well as the initial and subsequent fair value adjustments, are as follows:

	As Recorded by Stephens Federal	Initial Fair Value and Other Adjustments	Subsequent Fair Value and Other Adjustments	As Recorded by the Company
Consideration				
Common stock at \$18.95 per share, 36,945 shares			\$ —	\$ 700
Assets				
Cash and cash equivalents	\$ 24,079	\$ —	\$ —	\$ 24,079
Securities available-for-sale	2,720	—	—	2,720
Loans	103,166	(6,742)(1)	(962)(7)	95,462
Mortgage loans held for sale	572	—	—	572
Premises and equipment, net	5,308	(1,324)(2)	—	3,984
Real estate owned, net	6,198	(2,806)(3)	—	3,392
Accrued interest receivable	376	—	—	376
Restricted equity securities	143	—	—	143
Core deposit intangible	—	—	959(8)	959
Loan servicing rights	1,409	(40)(4)	—	1,369
Other assets	141	4,091(5)	975(9)	5,207
Total assets acquired	\$ 144,112	\$ (6,821)	972	138,263
Liabilities				
Deposits	\$ 139,160	\$ 54(6)	\$ —	\$ 139,214
Other liabilities	1,035	—	(93)(10)	942
Total liabilities assumed	\$ 140,195	\$ 54	(93)	140,156
Net liabilities assumed			1,065	(1,893)
Goodwill			\$ (1,065)(11)	\$ 2,593

## Explanation of fair value adjustments:

(1)

The net fair value adjustment includes a total gross fair value adjustment of \$8,892 to the unpaid principal balances of loans acquired, net of the existing allowance of \$1,979 and deferred loans fees of \$171. The gross fair value adjustment includes both credit, interest and liquidity components that comprise the entire discount. The fair value adjustment related to purchased credit impaired (“PCI”) loans was \$6,676, and the fair value adjustment on purchased

performing loans was \$2,216. Based on an evaluation of the expected future cash flows for PCI loans, the accretable difference expected to be recognized into income as a yield adjustment on loans was \$642. The entire discount on purchased performing loans will be accreted to income on a level-yield basis over each loan's contractual life.

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NOTE 2 — ACQUISITION (Continued)

(2)

Premises and equipment were adjusted to reflect recently appraised values of the land and buildings for each branch acquired and the Company's estimates of the fair value of furniture, fixtures and equipment.

(3)

The net adjustment reflects the fair value of real estate properties, less estimated costs to sell.

(4)

The adjustment reflects the fair value of loan servicing rights based upon the net present value of future servicing cash flows net of costs.

(5)

Represents adjustments in the net deferred tax assets resulting from the fair value adjustments related to the acquired assets and liabilities, identifiable intangibles and other deferred tax items. The fair value adjustment of the net deferred tax asset assumes an effective tax rate of approximately 36%.

(6)

The value adjustment to time deposits reflecting the differences in the contractual interest rates and those currently offered. The premium will be amortized into interest expense over a 3.7 year life using the straight line method.

(7)

Additional loans were identified as PCI, resulting in a net \$575 increase in the fair value discount of those loans. Additionally, fair value estimates were updated on certain loans, increasing the fair value discount approximately \$387. The total fair value adjustment on PCI loans was \$7,638. The final adjusted accretable difference expected to be recognized into income was \$616.

(8)

The value for the core deposit intangible at December 31, 2014.

(9)

Change in other assets of \$699 relates to changes in deferred taxes associated with the fair value discounts on PCI loans and a \$276 increase in deferred tax assets resulting from a change in the income tax rate used to calculate the initial deferred taxes from 36.0% to 38.0%.

(10)

This adjustment represents an adjustment to amounts determined to be over accrued by Stephens Federal for FDIC premiums owed.

(11)

Changes to goodwill are a direct result of the adjustments to net assets acquired.

The Company has determined the above noted acquisition constitutes a business combination as defined by generally accepted accounting principles. As such, the Company has recorded the assets purchased and liabilities assumed at their estimated fair values.

The estimated fair values are subject to refinement for up to one year after the closing date of the acquisition as additional information regarding closing date fair value becomes available. During this one year period, the causes of any changes in cash flow estimates are considered to determine whether the change results from circumstances that existed at the acquisition date or if the change results from an event that occurred after the date of acquisition.

With this acquisition, the Company expanded its presence in the northeast corner of Georgia in Stephens and Rabun Counties through the addition of three branches, which enhances our ability to grow by expanding our footprint into these nearby counties. None of the goodwill associated with this acquisition is deductible for income tax purposes.

The Company incurred transaction-related costs of \$645 thousand, of which \$315 were incurred in the year ended June 30, 2015. No transaction-related costs were incurred in the year ended June 30, 2016. Transaction-related costs are expensed as incurred as a component of noninterest expense. Transaction-related costs primarily include professional services and data processing fees.

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## NOTE 3 — EARNINGS PER SHARE (“EPS”)

Basic EPS is determined by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding for the period. ESOP shares are considered outstanding for this calculation unless unearned. The factors used in the earnings per common share computation follow:

	Year Ended	
	June 30, 2016	June 30, 2015
Earnings per share		
Net income	\$ 5,246	\$ 4,512
Less: distributed earnings allocated to participating securities	(16)	(24)
Less: (undistributed income) dividends in excess of earnings allocated to participating securities	(21)	(24)
Net earnings available to common shareholders	\$ 5,209	\$ 4,464
Weighted average common shares outstanding including participating securities	5,875,226	5,860,699
Less: participating securities	(40,905)	(62,502)
Less: average unearned ESOP shares	(134,625)	(167,566)
Weighted average common shares outstanding	5,699,696	5,630,631
Basic earnings per share	\$ 0.91	\$ 0.79
Weighted average common shares outstanding	5,699,696	5,630,631
Add: dilutive effects of assumed exercises of stock options	73,795	70,375
Average shares and dilutive potential common shares	5,773,491	5,701,006
Diluted earnings per share	\$ 0.90	\$ 0.78

During the years ended June 30, 2016 and 2015, there were 15,400 shares that were anti-dilutive as the weighted average exercise prices of outstanding stock options were in excess of the weighted average market value for the periods presented.

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## OCONEE FEDERAL FINANCIAL CORP.

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## NOTE 4 — SECURITIES AVAILABLE-FOR-SALE

Debt, mortgage-backed and equity securities have been classified in the consolidated balance sheets according to management's intent. U.S. Government agency mortgage-backed securities consist of securities issued by U.S. Government agencies and U.S. Government sponsored enterprises. Investment securities at June 30, 2016 and 2015 are as follows:

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
FHLMC common stock	\$ 20	\$ 131	\$ —	\$ 151
Certificates of deposit	7,470	64	—	7,534
Corporate debt securities	8,932	186	(2)	9,116
Municipal securities	33,508	989	(16)	34,481
SBA loan pools	1,268	8	(3)	1,273
U.S. Government agency mortgage-backed securities	68,103	1,331	(31)	69,403
U.S. Government agency bonds	9,957	169	—	10,126
Total available-for-sale	\$ 129,258	\$ 2,878	\$ (52)	\$ 132,084
	June 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
FHLMC common stock	\$ 20	\$ 160	\$ —	\$ 180
Certificates of deposit	7,221	29	(8)	7,242
Municipal securities	13,574	11	(152)	13,433
SBA loan pools	2,249	17	—	2,266
U.S. Government agency mortgage-backed securities	64,177	488	(523)	64,142
U.S. Government agency bonds	23,967	80	(143)	23,904
Total available-for-sale	\$ 111,208	\$ 785	\$ (826)	\$ 111,167

Securities pledged at June 30, 2016 and 2015 had a carrying amount of \$6,114 and \$5,951, respectively, and were pledged to secure public deposits.

At June 30, 2016 and 2015, there were no holdings of securities of any one issuer, other than the U.S. Government agencies and U.S. Government sponsored enterprises, in an amount greater than 10% of shareholders' equity.

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## NOTE 4 — SECURITIES AVAILABLE-FOR-SALE (Continued)

The following tables show the fair value and unrealized loss of securities that have been in unrealized loss positions for less than twelve months and for more than twelve months at June 30, 2016 and 2015. The table also shows the number of securities in an unrealized loss position for each category of investment security as of the respective dates.

June 30, 2016

	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Loss	Number in Unrealized Loss(1)	Fair Value	Unrealized Loss	Number in Unrealized Loss(1)	Fair Value	Unrealized Loss	Number in Unrealized Loss(1)
Available-for-sale:									
Municipal securities	\$ 2,574	\$ (11)	5	\$ 716	\$ (5)	2	\$ 3,290	\$ (16)	7
Corporate debt securities	1,018	(2)	2	—	—	—	1,018	(2)	2
SBA loan pools	—	—	—	508	(3)	1	508	(3)	1
U.S. Government agency mortgage-backed securities	1,057	(1)	1	2,982	(30)	—	4,039	(31)	1
U.S. Government agency bonds	—	—	—	—	—	—	—	—	—
	\$ 4,649	\$ (14)	8	\$ 4,206	\$ (38)	3	\$ 8,855	\$ (52)	11

June 30, 2015

	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Loss	Number in Unrealized Loss(1)	Fair Value	Unrealized Loss	Number in Unrealized Loss(1)	Fair Value	Unrealized Loss	Number in Unrealized Loss(1)
Available-for-sale:									
Certificates of deposit	\$ 1,737	\$ (6)	7	\$ 247	\$ (2)	1	\$ 1,984	\$ (8)	8
Municipal securities	10,472	(152)	30	—	—	—	10,472	(152)	30
U.S. Government agency mortgage-backed securities	18,981	(195)	15	11,521	(328)	12	30,502	(523)	27

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U.S. Government agency bonds	6,951	(68)	4	4,920	(75)	3	11,871	(143)	7
	\$ 38,141	\$ (421)	56	\$ 16,688	\$ (405)	16	\$ 54,829	\$ (826)	72

(1)  
Actual amounts.

None of the unrealized losses at June 30, 2016 were recognized into net income for the year ended June 30, 2016 because the issuer's bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value of these securities is expected to recover as they approach their maturity date or reset date. None of the unrealized losses at June 30, 2015 were recognized as having OTTI during the year ended June 30, 2016.

The amortized cost and fair value of debt securities classified as available-for-sale at June 30, 2016 and 2015 by contractual maturity are summarized in the following table. FHLMC common stock is not included as it has no contractual maturity date.

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## NOTE 4 — SECURITIES AVAILABLE-FOR-SALE (Continued)

	June 30, 2016		June 30, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less than one year	\$ 3,740	\$ 3,751	\$ 1,244	\$ 1,249
Due from one to five years	8,104	8,356	22,156	22,042
Due from five to ten years	16,819	17,086	11,450	11,412
Due after ten years	31,204	32,064	9,912	9,876
Mortgage-backed securities(1)	69,371	70,676	66,426	66,408
Total	\$ 129,238	\$ 131,933	\$ 111,188	\$ 110,987

(1)

Includes SBA loan pools.

The following table presents the gross proceeds from sales of securities available-for-sale and gains or losses recognized for the years ended June 30, 2016 and 2015:

	Years Ended	
	June 30, 2016	June 30, 2015
Available-for-sale:		
Proceeds	\$ 6,904	\$ 11,174
Gross gains	128	149
Gross losses	—	—

## NOTE 5 — LOANS

The components of loans at June 30, 2016 and 2015 were as follows:

	June 30, 2016	June 30, 2015
Real estate loans:		
One-to-four family	\$ 242,067	\$ 256,321
Multi-family	1,996	2,574
Home equity	6,433	8,198
Nonresidential	20,310	21,685
Agricultural	2,958	4,164
Construction and land	14,332	14,590
Total real estate loans	288,096	307,532
Commercial and industrial	176	184

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Consumer and other loans	4,915	2,745
Total loans	293,187	310,461
Deferred net loan fees	(1,124)	(1,194)
Total loans net of deferred loan fees	\$ 292,063	\$ 309,267

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## NOTE 5 — LOANS (Continued)

The following table presents the activity in the allowance for loan losses for the years ended June 30, 2016 by portfolio segment:

	Year Ended June 30, 2016				
	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
One-to-four family	\$ 910	\$ 270	\$ (447)	\$ —	\$ 733
Multi-family	4	—	—	—	4
Home equity	1	73	(72)	—	2
Nonresidential	55	75	—	—	130
Agricultural	4	1	—	—	5
Construction and land	25	23	(9)	—	39
Total real estate loans	999	442	(528)	—	913
Commercial and industrial	—	6	—	—	6
Consumer and other loans	9	3	(9)	—	3
Total loans	\$ 1,008	\$ 451	\$ (537)	\$ —	\$ 922

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at June 30, 2016:

	At June 30, 2016					
	Ending Allowance on Loans:			Loans:		Collectively Evaluated for Impairment
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Non-PCI	PCI(1)	
	Non-PCI	PCI(1)	Non-PCI	PCI(1)		
Real estate loans:						
One-to-four family	\$ 55	\$ 46	\$ 632	\$ 1,014	\$ 1,904	\$ 239,149
Multi-family	—	—	4	—	—	1,996
Home equity	—	—	2	—	—	6,433
Nonresidential	—	72	58	—	1,492	18,818
Agricultural	—	—	5	448	—	2,510
Construction and land	—	11	28	—	525	13,807
Total real estate loans	55	129	729	1,462	3,921	282,713
Commercial and industrial	—	—	6	—	—	176
Consumer and other loans	—	—	3	—	—	4,915

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Total loans	\$ 55	\$ 129	\$ 738	\$ 1,462	\$ 3,921	\$ 287,804
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(1)  
PCI loans include all loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

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## NOTE 5 — LOANS (Continued)

The following table presents the activity in the allowance for loan losses for the years ended June 30, 2015 by portfolio segment:

	Year Ended June 30, 2015				
	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
One-to-four family	\$ 736	\$ 174	\$ —	\$ —	\$ 910
Multi-family	4	—	—	—	4
Home equity	1	40	(40)	—	1
Nonresidential	52	3	—	—	55
Agricultural	—	4	—	—	4
Construction and land	59	(34)	—	—	25
Total real estate loans	852	187	(40)	—	999
Commercial and industrial	—	—	—	—	—
Consumer and other loans	3	8	(2)	—	9
Total loans	\$ 855	\$ 195	\$ (42)	\$ —	\$ 1,008

The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at June 30, 2015:

	At June 30, 2015					
	Ending Allowance on Loans:			Loans:		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Non-PCI	PCI(1)
Real estate loans:						
One-to-four family	\$ 197	\$ 6	\$ 707	\$ 2,666	\$ 2,778	\$ 250,877
Multi-family	—	—	4	—	—	2,574
Home equity	—	—	1	—	—	8,198
Nonresidential	—	10	45	—	2,627	19,058
Agricultural	—	—	4	487	954	2,723
Construction and land	—	—	25	—	599	13,991
Total real estate loans	197	16	786	3,153	6,958	297,421
Commercial and industrial	—	—	—	—	—	184
Consumer and other loans	7	—	2	7	—	2,738

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Total loans	\$ 204	\$ 16	\$ 788	\$ 3,160	\$ 6,958	\$ 300,343
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(1)  
PCI loans include all loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

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## NOTE 5 — LOANS (Continued)

The tables below present loans that were individually evaluated for impairment by portfolio segment at June 30, 2016 and 2015, including the average recorded investment balance and interest earned for the years ended June 30, 2016 and 2015:

	June 30, 2016				
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no recorded allowance:					
Real estate loans:					
One-to-four family	\$ 1,787	\$ 992	\$ —	\$ 2,198	\$ 113
Multi-family	—	—	—	—	—
Home equity	185	—	—	—	—
Nonresidential	2,192	1,111	—	1,209	72
Agricultural	997	448	—	945	—
Construction and land	359	185	—	392	35
Total real estate loans	5,520	2,736	—	4,744	220
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total	\$ 5,520	\$ 2,736	\$ —	\$ 4,744	\$ 220
With recorded allowance:					
Real estate loans:					
One-to-four family	\$ 2,021	\$ 1,918	\$ 101	\$ 1,980	\$ 89
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	404	382	72	851	25
Agricultural	—	—	—	—	—
Construction and land	767	347	11	174	61
Total real estate loans	3,192	2,647	184	3,005	175
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total	\$ 3,192	\$ 2,647	\$ 184	\$ 3,005	\$ 175
Totals:					
Real estate loans	\$ 8,712	\$ 5,383	\$ 184	\$ 7,749	\$ 395
Consumer and other loans	—	—	—	—	—
Total	\$ 8,712	\$ 5,383	\$ 184	\$ 7,749	\$ 395

The unpaid principal balance and recorded investment in PCI loans included in the table above was \$7,698 and \$4,369, respectively at June 30, 2016.

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## NOTE 5 — LOANS (Continued)

	June 30, 2015				
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no recorded allowance:					
Real estate loans:					
One-to-four family	\$ 4,651	\$ 3,403	\$ —	\$ 1,889	\$ 92
Multi-family	—	—	—	—	—
Home equity	207	—	—	—	—
Nonresidential	2,830	1,307	—	654	39
Agricultural	2,893	1,441	—	721	45
Construction and land	1,271	599	—	300	23
Total real estate loans	11,852	6,750	—	3,564	199
Commercial and industrial	—	—	—	—	—
Consumer and other loans	—	—	—	—	—
Total	\$ 11,852	\$ 6,750	\$ —	\$ 3,564	\$ 199
With recorded allowance:					
Real estate loans:					
One-to-four family	\$ 2,082	\$ 2,042	\$ 203	\$ 1,658	\$ 28
Multi-family	—	—	—	—	—
Home equity	—	—	—	—	—
Nonresidential	1,938	1,319	10	660	25
Agricultural	—	—	—	—	—
Construction and land	—	—	—	—	—
Total real estate loans	4,020	3,361	213	2,318	53
Commercial and industrial	—	—	—	—	—
Consumer and other loans	9	7	7	—	—
Total	\$ 4,029	\$ 3,368	\$ 220	\$ 2,318	\$ 53
Totals:					
Real estate loans	\$ 15,872	\$ 10,111	\$ 213	\$ 5,882	\$ 252
Consumer and other loans	9	7	7	—	—
Total	\$ 15,881	\$ 10,118	\$ 220	\$ 5,882	\$ 252

The unpaid principal balance and recorded investment in PCI loans included in the table above was \$13,208 and

\$7,445, respectively at June 30, 2015.

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## NOTE 5 — LOANS (Continued)

## Purchased Credit Impaired Loans:

The Company has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The following table presents the carrying amount of those loans at June 30, 2016 and 2015:

## PCI Loans, net of related discounts:

	June 30, 2016	June 30, 2015
Real estate loans:		
One-to-four family	\$ 1,858	\$ 2,772
Multi-family	—	—
Home equity	—	—
Nonresidential	1,420	2,617
Agricultural	—	954
Construction and land	514	599
Total real estate loans	3,792	6,942
Commercial and industrial	—	—
Consumer and other loans	—	—
Total loans	\$ 3,792	\$ 6,942

Carrying amounts listed above are net of an allowance for loan losses of \$129 and \$16 at June 30, 2016 and 2015, respectively.

The following table presents the changes in the carrying value and the accretable yield on PCI loans for the years ended June 30, 2016 and 2015:

	Year Ended June 30, 2016		Year Ended June 30, 2015	
	Accretable Yield	Carrying Value	Accretable Yield	Carrying Value
Balance at beginning of period	\$ (694)	\$ 6,942	\$ —	\$ —
Acquired loans	—	—	(616)	10,947
Payments and other exit events	—	(2,540)	4	(3,914)
Accretion	497	(497)	206	(75)
Reclassification from nonaccretable to accretable	(1,143)	—	(288)	—
Change in the allowance	—	(113)	—	(16)
Balance at end of period	\$ (1,340)	\$ 3,792	\$ (694)	\$ 6,942



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## NOTE 5 — LOANS (Continued)

Income is not recognized on PCI loans if the Company cannot reasonably estimate the amount and timing of cash flows expected to be collected. The carrying amount of such loans at June 30, 2016 and 2015 is as follows:

	June 30, 2016	June 30, 2015
Balance at beginning of year	\$ 2,311	\$ 3,366
Additions	132	1,407
Reductions from payments and liquidations	(1,304)	(2,462)
Balance at end of period	\$ 1,139	\$ 2,311

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

Total past due loans and nonaccrual loans at June 30, 2016:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	\$ 7,086	\$ 1,001	\$ 863	\$ 8,950	\$ 233,117	\$ 242,067	\$ 2,133	\$ —
Multi-family	—	—	—	—	1,996	1,996	—	—
Home equity	94	22	84	200	6,233	6,433	126	—
Nonresidential	—	48	942	990	19,320	20,310	942	—
Agricultural	—	—	—	—	2,958	2,958	531	—
Construction and land	93	—	25	118	14,214	14,332	25	—
Total real estate loans	7,273	1,071	1,914	10,258	277,838	288,096	3,757	—
Commercial and industrial	—	—	—	—	176	176	—	—
Consumer and other loans	—	—	—	—	4,915	4,915	—	—

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Total \$ 7,273 \$ 1,071 \$ 1,914 \$ 10,258 \$ 282,929 \$ 293,187 \$ 3,757 \$ —

PCI past due and nonaccrual loans at June 30, 2016:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	\$ —	\$ 389	\$ 21	\$ 410	\$ 1,486	\$ 1,896	\$ 172	\$ —
Nonresidential	—	48	942	990	502	1,492	942	—
Agricultural	—	—	—	—	—	—	—	—
Construction and land	—	—	25	25	508	533	25	—
Total loans	\$ —	\$ 437	\$ 988	\$ 1,425	\$ 2,496	\$ 3,921	\$ 1,139	\$ —

PCI loans for which the Company cannot reasonably estimate the amount and timing of future cash flows are classified as nonaccrual.

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## NOTE 5 — LOANS (Continued)

Total past due and nonaccrual loans by portfolio segment at June 30, 2015:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	\$ 5,871	\$ 1,243	\$ 2,311	\$ 9,425	\$ 246,896	\$ 256,321	\$ 2,311	\$ —
Multi-family	—	—	—	—	2,574	2,574	—	—
Home equity	49	—	—	49	8,149	8,198	—	—
Nonresidential	229	313	1,108	1,650	20,035	21,685	1,379	—
Agricultural	—	—	—	—	4,164	4,164	487	—
Construction and land	78	—	—	78	14,512	14,590	—	—
Total real estate loans	6,227	1,556	3,419	11,202	296,330	307,532	4,177	—
Commercial and industrial	—	—	—	—	184	184	—	—
Consumer and other loans	1	1	—	2	2,743	2,745	—	—
Total	\$ 6,228	\$ 1,557	\$ 3,419	\$ 11,204	\$ 299,257	\$ 310,461	\$ 4,177	\$ —

PCI past due and nonaccrual loans at June 30, 2015:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	\$ 237	\$ —	\$ 932	\$ 1,169	\$ 1,609	\$ 2,778	\$ 932	\$ —
Nonresidential	14	313	1,108	1,435	1,192	2,627	1,379	—

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Agricultural	—	—	—	—	954	954	—	—
Construction and land	—	—	—	—	599	599	—	—
Total loans	\$ 251	\$ 313	\$ 2,040	\$ 2,604	\$ 4,354	\$ 6,958	\$ 2,311	\$ —

Troubled Debt Restructurings:

At June 30, 2016 and 2015, total loans that have been modified as troubled debt restructurings were \$1,588 and \$487, respectively, which consisted of two agricultural loans, two home equity lines of credit, and one one-to-four family first lien at June 30, 2016 and one home equity and one agricultural loan at June 30, 2015. All loans were acquired and initially recorded at fair value. An additional allowance of \$55 has been specifically reserved for these loans.

Additionally, there were no commitments to lend any additional amounts under either loan or any payment default on any loan after the modification. The three troubled debt restructurings during the year ended June 30, 2016 all involved renewing existing loans as interest-only. No reductions of principal or interest rates were granted. No loans restructured during the past twelve months subsequently defaulted.

Loan Grades:

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

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## NOTE 5 — LOANS (Continued)

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

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

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

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

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

Total loans by risk grade and portfolio segment at June 30, 2016:

	Pass	Pass-Watch	Special Mention	Substandard	Doubtful	Total
Real estate loans:						
One-to-four family	\$ 227,887	\$ 6,805	\$ 1,890	\$ 5,485	\$ —	\$ 242,067
Multi-family	1,996	—	—	—	—	1,996
Home equity	5,941	106	260	126	—	6,433
Nonresidential	13,229	4,095	1,494	1,492	—	20,310
Agricultural	1,353	398	676	531	—	2,958
Construction and land	12,646	878	239	569	—	14,332
Total real estate loans	263,052	12,282	4,559	8,203	—	288,096
Commercial and industrial	157	19	—	—	—	176
Consumer and other loans	4,907	—	3	5	—	4,915
Total	\$ 268,116	\$ 12,301	\$ 4,562	\$ 8,208	\$ —	\$ 293,187

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**NOTE 5 — LOANS (Continued)**

Total loans by risk grade and portfolio segment at June 30, 2015:

	Pass	Pass-Watch	Special Mention	Substandard	Doubtful	Total
Real estate loans:						
One-to-four family	\$ 242,399	\$ 6,909	\$ 1,568	\$ 5,445	\$ —	\$ 256,321
Multi-family	2,574	—	—	—	—	2,574
Home equity	7,840	184	174	—	—	8,198
Nonresidential	13,226	4,275	1,558	2,355	271	21,685
Agricultural	1,295	423	1,005	1,441	—	4,164
Construction and land	12,586	920	485	599	—	14,590
Total real estate loans	279,920	12,711	4,790	9,840	271	307,532
Commercial and industrial	169	15	—	—	—	184
Consumer and other loans	2,725	6	7	7	—	2,745
Total	\$ 282,814	\$ 12,732	\$ 4,797	\$ 9,847	\$ 271	\$ 310,461

At June 30, 2016 and 2015, consumer mortgage loans secured by residential real estate properties totaling \$282 and \$1,720 respectively, were in formal foreclosure proceedings and are included in one-to-four family loans.

Loans to principal officers, directors, and their affiliates during the years ended June 30, 2016 and 2015 were as follows:

	June 30, 2016	June 30, 2015
Beginning balance	\$ 1,313	\$ 766
New loans	—	574
Repayments	(35)	(27)
Ending balance	\$ 1,278	\$ 1,313

Directors and officers of the Company are customers of the institution in the ordinary course of business. Loans to directors and executive officers have terms consistent with those offered to other customers. In the opinion of management, these loans do not involve more than normal risk of collectability nor do they present other unfavorable features.

**NOTE 6 — PREMISES AND EQUIPMENT**

Premises and equipment at June 30, 2016 and 2015 were as follows:

	June 30, 2016	June 30, 2015
Land	\$ 1,425	\$ 1,425
Buildings and improvements	7,913	7,891

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Furniture, fixtures and equipment	3,436	3,430
Computer software	238	236
	13,012	12,982
Less: accumulated depreciation	(6,201)	(5,924)
	\$ 6,811	\$ 7,058

Depreciation expense was \$451 and \$354 for the years ended June 30, 2016 and 2015, respectively.

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## NOTE 7 — GOODWILL AND INTANGIBLE ASSETS

The following tables present the carrying value of goodwill and the core deposit intangible at June 30, 2016 and 2015:

	June 30, 2016	June 30, 2015
Balance at beginning of year	\$ 2,593	\$ —
Additions	—	2,593
Impairment	—	—
Balance at end of year	\$ 2,593	\$ 2,593

	June 30, 2016	June 30, 2015
Core deposit intangible gross	\$ 874	\$ 959
Accumulated amortization	(130)	(85)
Core deposit intangible net	\$ 744	\$ 874

Amortization expense for the year ended June 30, 2016 and 2015 was \$130 and \$85, respectively.

Estimated amortization expense for each of the next five years is as follows:

2017	\$ 110
2018	94
2019	80
2020	68
2021	58

## NOTE 8 — DEPOSITS

At June 30, 2016 and 2015, time deposit accounts with balances over \$250 totaled approximately \$11,134 and \$12,502, respectively. Scheduled maturities of certificates of deposit at June 30, 2016 are as follows:

	June 30, 2016
2017	\$ 175,053
2018	36,238
2019	4,619
2020	4,101
2021	3,971
	\$ 223,982

There are no certificates of deposit scheduled to mature after 2021. The Company does not take brokered certificates of deposit.

Directors and executive officers were customers of, and had transactions with, the Company in the ordinary course of business. Included in such transactions are deposit accounts, all of which were made under normal terms. The aggregate amount of these deposit accounts was \$1,977 and \$1,910 at June 30, 2016 and 2015, respectively.

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## NOTE 9 — INCOME TAXES

Income tax expense for the years ended June 30, 2016 and 2015 was as follows:

	June 30, 2016	June 30, 2015
Current federal expense	\$ 232	\$ 619
Current state expense	194	148
Deferred federal expense (benefit)	1,590	1,551
Deferred state expense (benefit)	16	372
Total	\$ 2,032	\$ 2,690

Temporary differences between tax and financial reporting that result in net deferred tax assets are as follows at June 30, 2016 and 2015:

	June 30, 2016	June 30, 2015
Deferred tax assets:		
Fair value adjustments from acquisition	\$ 1,438	\$ 3,047
Allowance for loan losses	325	382
Deferred compensation	266	281
Basis difference in premises and equipment	143	(63)
Acquired net operating loss (“NOL”)	132	139
Equity compensation plans	64	327
Real estate owned	39	(16)
Other	155	96
Total deferred tax assets	2,562	4,193
Deferred tax liabilities:		
Securities available-for-sale	(1,017)	15
Prepaid expenses	(97)	(126)
FHLB stock dividends	(71)	(82)
Deferred loan fees, net	(249)	(234)
Total deferred tax liabilities	(1,434)	(427)
Net deferred tax asset	\$ 1,128	\$ 3,766

A NOL of \$375 was acquired from the Stephens Federal acquisition at December 1, 2014. At June 30, 2016 and 2015, the NOL remaining totaled \$344 and \$364, respectively, with a deferred tax asset of \$132 and \$139, respectively. The NOL will expire in 2031. The realization of the deferred tax asset resulting from the NOL is dependent upon generating sufficient taxable income prior to the NOL’s expiration. In assessing the realizability of the deferred tax asset, management considered whether it is more likely than not that some portion or all of the deferred tax asset would not be realized. Based on the Company’s current and expected future financial performance as well as strong

asset quality, management determined that no valuation allowance was necessary at June 30, 2016.

Retained earnings as of June 30, 2016 and 2015 includes approximately \$5,284 representing reserve method bad debt reserves originating prior to December 31, 1987 for which no deferred income taxes are required to be provided.

These reserves may be included in taxable income if the Company pays dividends in excess of its accumulated earnings and profits (as defined by the Internal Revenue Code) or in the event of a distribution in partial or complete liquidation of the Company.

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## NOTE 9 — INCOME TAXES (Continued)

A reconciliation of the amount computed by applying the federal statutory rate (34%) to pretax income with income tax expense for the years ended June 30, 2016 and 2015 is as follows:

	June 30, 2016		June 30, 2015	
	Amount	%	Amount	%
Tax at statutory federal income tax rate	\$ 2,475	34.00%	\$ 2,449	34.00%
Increase (decrease) resulting from:				
State income tax expense	139	(1.57)	293	4.07
Life insurance benefits	(175)	(2.40)	(97)	(1.35)
Tax exempt interest income	(174)	(2.39)	(56)	(0.77)
Acquisition related costs	—	0.00	96	1.34
Other – net	(233)	0.27	5	0.07
Total	\$ 2,032	27.92%	\$ 2,690	37.36%

The Company has uncertain tax positions and related tax reserves in place for the years ended June 30, 2016 and 2015 of \$186 and \$281, respectively. No amounts were accrued for penalties or interest at June 30, 2016 and 2015. The Company is subject to U.S. federal income tax as well as income tax of the states of South Carolina and Georgia. The Company is no longer subject to examination by taxing authorities for years before 2012.

## NOTE 10 — COMMITMENTS

Loan commitments and related activities: Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off-balance-sheet risk at June 30, 2016 and 2015 was as follows:

	2016		2015	
	Fixed	Variable	Fixed	Variable
Loan commitments	\$ 2,924	\$ —	\$ 662	\$ —
Unused lines of credit	\$ 13,835	\$ 1,432	\$ 5,228	\$ 2,656

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments are primarily for the purpose of financing the purchase, the refinance, or the construction of residential real estate. At June 30, 2016, these commitments have interest rates ranging from 2.3% to 7.95% and maturities ranging from 1 to 30 years. At June 30, 2015, these commitments have interest rates ranging from 4.13% to 4.5% and maturities ranging from 15 to 30 years.

Financial instruments with off-balance-sheet risk: The Company has no additional financial instruments with off-balance-sheet risk.



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## NOTE 11 — REGULATORY CAPITAL REQUIREMENTS

Savings and loan associations are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes as of June 30, 2016, the Association met all capital adequacy requirements to which it is subject. Savings and loan holding companies became subject to capital requirements on January 1, 2015. However, such capital requirements do not apply to savings and loan holding companies with assets of less than \$1,000.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At June 30, 2016 and 2015, the most recent regulatory notifications categorized the Association as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Association's category.

The Association's actual and minimum capital requirements to be well-capitalized under prompt corrective action provisions are as follows:

	June 30, 2016					
	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets	\$ 74,722	31.00%	\$ 19,284	8.00%	\$ 24,105	10.00%
Common equity tier 1 capital to risk weighted assets	73,741	30.59	10,847	4.50	15,668	6.50
Tier 1 (core) capital to risk weighted assets	73,741	30.59	14,463	6.00	19,284	8.00
Tier 1 (core) capital to tangible assets	73,741	15.40	19,152	4.00	23,940	5.00
	June 30, 2015					
	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets	\$ 75,058	32.28%	\$ 18,600	8.00%	\$ 23,250	10.00%
Tier 1 (core) capital to risk weighted assets	73,990	31.82	10,462	4.50	15,112	6.50
	73,990	31.82	13,950	6.00	18,600	8.00

Tier 1 (core) capital to tangible assets

Tangible capital to tangible assets	73,990	15.39	14,423	3.00	24,038	5.00
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The Qualified Thrift Lender test requires at least 65% of assets be maintained in housing-related finance and other specified areas. If this test is not met, limits are placed on growth, branching, new investments, FHLB advances and dividends, or the Association must convert to a commercial bank charter. Management believes this test is met.

Dividend Restrictions — The Company’s principal source of funds for dividend payments is dividends received from the Association. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in

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OCONEE FEDERAL FINANCIAL CORP.

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NOTE 11 — REGULATORY CAPITAL REQUIREMENTS (Continued)

any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During 2016, the Association could, without prior approval, declare dividends of approximately \$8,870 (based on an annualized net income for the calendar year ending 2016).

NOTE 12 — FAIR VALUE MEASUREMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Investment Securities:

The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Impaired Loans:

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Loan Servicing Rights:

Fair value is determined based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model utilizes assumptions that market participants would use in estimating future net servicing income and that can be validated against available market data and results in a Level 3 classification.

Real estate owned:

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of

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## NOTE 12 — FAIR VALUE MEASUREMENTS (Continued)

cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals, which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, management reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

Assets and liabilities measured at fair value on a recurring basis at June 30, 2016 and 2015 are summarized below:

	Fair Value Measurements			
	(Level 2)	(Level 3)	(Level 2)	(Level 3)
	June 30, 2016		June 30, 2015	
Financial assets:				
Securities available-for-sale:				
FHLMC common stock	\$ 151	\$ —	\$ 180	\$ —
Certificates of deposit	7,534	—	7,242	—
Corporate debt securities	9,116	—	—	—
Municipal securities	34,481	—	13,433	—
SBA loan pools	1,273	—	2,266	—
U.S. Government agency mortgage-backed securities	69,403	—	64,142	—
U.S. Government agency bonds	10,126	—	23,904	—
Total securities available-for-sale	132,084	—	111,167	—
Loan servicing rights	—	1,046	—	1,396
Total financial assets	\$ 264,017	\$ 1,046	\$ 222,334	\$ 1,396

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs Level 3 for the years ended June 30, 2016 and 2015:

Fair Value  
Measurements  
(Level 3)

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	Year Ended June 30, 2016	Year Ended June 30, 2015
	Loan Servicing Rights	Loan Servicing Rights
Balance at beginning of year:	\$ 1,396	\$ —
Purchases	—	1,369
Change in fair value	(350)	27
Balance at end of year:	\$ 1,046	\$ 1,396

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## NOTE 12 — FAIR VALUE MEASUREMENTS (Continued)

The table below presents assets measured at fair value on a non-recurring basis by level at June 30, 2016 and 2015:

	Fair Value Measurements	
	(Level 3)	(Level 3)
	June 30, 2016	June 30, 2015
Financial assets:		
Impaired loans, with specific allocations:		
One-to-four family	\$ 1,817	\$ 1,839
Nonresidential	310	1,309
Construction and land	336	—
Total financial assets	2,463	3,148
Non-financial assets:		
Real estate owned, net:		
One-to-four family	899	1,335
Nonresidential	267	365
Construction and land	188	392
Total non-financial assets	1,354	2,092
Total assets measured at fair value on a non-recurring basis	\$ 3,817	\$ 5,240

The Company's impaired loans at June 30, 2016 and 2015 were measured at fair value based primarily upon the estimated value of real estate collateral less costs to sell. The carrying amounts of these loans were \$2,463 and \$3,148, respectively, which consisted of valuation allowances of \$184 and \$220, respectively. Not shown in the table above, there were recorded investments at June 30, 2016 and 2015 of consumer and other loans with a recorded investment amount of \$7 with a valuation allowance of \$7. The impact to the provision for loan losses from the change in the valuation allowance for the years ended June 30, 2016 and 2015 was a decrease of \$36 and an increase of \$193, respectively.

Real estate owned is carried at the lower of carrying value or fair value less costs to sell. The carrying value of real estate owned and their respective valuation allowances at June 30, 2016 and 2015 were \$1,354 and \$2,092 and \$102 and \$84, respectively. The resulting write-downs for measuring real estate owned at the lower of carrying or fair value less costs to sell for the years ended June 30, 2016 and 2015 were \$193 and \$196, respectively.

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## OCONEE FEDERAL FINANCIAL CORP.

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## NOTE 12 — FAIR VALUE MEASUREMENTS (Continued)

The table below presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value at June 30, 2016 and 2015:

	Level 3 Quantitative Information			Unobservable Inputs	Range
	June 30, 2016 Fair Value	June 30, 2015 Fair Value	Valuation Technique		
Loan servicing rights	\$ 1,046	\$ 1,396	Discounted cash flows	Discount rate, estimated timing of cash flows	9% to 10%
Impaired real estate loans net, with specific allocations:					
One-to-four family	\$ 1,817	\$ 1,839	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 30%
Nonresidential	310	1,309	Discounted cash flows	Discount rate, estimated timing of cash flows	2% to 28%
Construction and land	336	—	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 30%
Real estate owned net:					
One-to-four family	\$ 899	\$ 1,335	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20%
Nonresidential	267	365	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20%
Construction and land	188	392	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20%

The carrying amounts and estimated fair values of the Company's on-balance sheet financial instruments at June 30, 2016 and 2015 are summarized below:

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June 30, 2016

	Carrying Amount	Fair Value (Level 1)	(Level 2)	(Level 3)	Total
Financial assets					
Securities available-for-sale	\$ 132,084	\$ —	\$ 132,084	\$ —	\$ 132,084
Loans, net	291,141	—	—	296,203	296,203
Loans held for sale(1)	129	—	—	129	129
Loan servicing rights	1,046	—	—	1,046	1,046
Restricted equity securities	1,021	N/A	N/A	N/A	N/A
Financial liabilities					
Deposits	\$ 399,634	\$ 175,652	\$ 224,037	\$ —	\$ 399,689

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## NOTE 12 — FAIR VALUE MEASUREMENTS (Continued)

	June 30, 2015				Total
	Carrying Amount	Fair Value (Level 1)	(Level 2)	(Level 3)	
Financial assets					
Securities available-for-sale	\$ 111,167	\$ —	\$ 111,167	\$ —	\$ 111,167
Loans, net	308,259	—	—	310,116	310,116
Loans held for sale(1)	118	—	—	118	118
Loan servicing rights	1,396	—	—	1,396	1,396
Restricted equity securities	440	N/A	N/A	N/A	N/A
Financial liabilities					
Deposits	\$ 394,093	\$ 137,618	\$ 256,681	\$ —	\$ 394,299

(1)

Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors and result in a Level 2 classification.

## NOTE 13 — EMPLOYEE BENEFIT PLANS

The Company has deferred compensation agreements with certain of its directors whereby director fees are withheld to fund insurance contracts from which the funds will ultimately be disbursed. These agreements require the Company to make payments to such directors beginning at the age set forth in the agreement or upon death of the director if prior to the minimum age requirement. The directors vest ratably over periods established in the agreements. Interest on the liabilities is charged to earnings based on imputed interest rates established at the beginning of each agreement, which range from 6.69% to 8.05% at both June 30, 2016 and 2015, respectively. The total expense incurred under these plans for the years ended June 30, 2016 and 2015 was \$55 and \$59, respectively. The recorded liability for these agreements was \$701 and \$739 at June 30, 2016 and 2015, respectively, and is included in other accrued liabilities in the consolidated balance sheet.

To provide funds for the payments under these deferred compensation agreements, the Company has purchased insurance policies on the lives of the directors covered by these plans.

The Company has the option of making an annual contribution to a profit-sharing plan for all full-time employees over the age of 21 having completed one year of service. The Company has exercised this option in 2016 and 2015, and as such, total expense under the profit sharing plan for each of the years ended June 30, 2016 and 2015 was \$226 and \$101, respectively.

## NOTE 14 — EMPLOYEE STOCK OWNERSHIP PLAN (“ESOP”)

Employees participate in an Employee Stock Ownership Plan (“ESOP”). The ESOP borrowed from the Company to purchase 248,842 shares of the Company’s common stock at \$10 per share during 2011. The Company makes discretionary contributions to the ESOP, and pays dividends on unallocated shares to the ESOP, and the ESOP uses funds it receives to repay the loan. When loan payments are made, ESOP shares are allocated to participants based on

relative compensation and expense is recorded. Dividends on allocated shares increase participant accounts. Participants receive the shares at the end of employment. During the year ended June 30, 2016 and 2015, \$100 of discretionary contributions were made to the ESOP for debt retirement, which resulted in the

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## NOTE 14 — EMPLOYEE STOCK OWNERSHIP PLAN (“ESOP”) (Continued)

release of additional shares and recognition of additional compensation expense of \$160 and \$140, respectively. ESOP compensation expense recognized for the years ended June 30, 2016 and 2015 was \$508 and \$475, respectively.

Shares held by the ESOP at June 30, 2016 and 2015 were as follows:

	June 30, 2016	June 30, 2015
Committed to be released to participants	10,602	9,938
Allocated to participants	112,043	85,248
Unearned	126,197	153,656
Total ESOP shares	248,842	248,842
Fair value of unearned shares	\$ 2,470	\$ 2,827

## NOTE 15 — STOCK BASED COMPENSATION

On April 5, 2012, the shareholders of Oconee Federal Financial Corp. approved the Oconee Federal Financial Corp. 2012 Equity Incentive Plan (the “Plan”) for employees and directors of the Company. The Plan authorizes the issuance of up to 435,472 shares of the Company’s common stock, with no more than 124,420 of shares as restricted stock awards and 311,052 as stock options, either incentive stock options or non-qualified stock options. The exercise price of options granted under the Plan may not be less than the fair market value on the date the stock option is granted. The compensation committee of the board of directors has sole discretion to determine the amount and to whom equity incentive awards are granted.

On January 23, 2015, the compensation committee of the board of directors approved the issuance of 7,700 stock options to purchase Company stock and 12,600 shares of restricted stock to one of the Company’s officers. Stock options and restricted stock have vesting periods of seven years, a percentage of which vests annually at each anniversary date of grant. Stock options expire ten years after issuance. Apart from the vesting schedule for both stock options and restricted stock, there are no performance-based conditions or any other material conditions applicable to the awards issued.

On February 5, 2016, the compensation committee of the board of directors approved the issuance of 21,000 stock options to purchase Company stock and 7,000 shares of restricted stock were granted to officers. Stock options and restricted stock have vesting periods of five years or seven years, a percentage of which vests annually on each anniversary of the grant date. The weighted average vesting period of stock options and restricted stock granted was 5.7 years and 6.0 years, respectively. Stock options expire ten years after issuance. Apart from the vesting schedule for both stock options and restricted stock, there are no performance-based conditions or any other material conditions applicable to the awards issued.

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## NOTE 15 — STOCK BASED COMPENSATION (Continued)

The following table summarizes stock option activity for the year ended June 30, 2016:

	Options	Weighted-Average Exercise Price/Share	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value(1)
Outstanding – July 1, 2015	248,686	\$ 12.02		
Granted	21,000	19.40		
Exercised	—	—		
Forfeited	(7,700)	17.16		
Outstanding – June 30, 2016	261,986	\$ 12.46	3.35	\$ 1,862,592
Fully vested and exercisable at June 30, 2016	169,954	\$ 11.65	3.35	\$ 1,346,036
Expected to vest in future periods	92,032			
Fully vested and expected to vest – June 30, 2016	261,986	\$ 12.46	3.35	\$ 1,862,592

(1)

The intrinsic value for stock options is defined as the difference between the current market value and the exercise price. The current market price was based on the closing price of common stock of \$19.57 per share on June 30, 2016.

The fair value for each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model that uses various assumptions. The Company uses the U.S. Treasury yield curve in effect at the time of the grant to determine the risk-free interest rate. The expected dividend yield is estimated using the projected annual dividend level and recent stock price of the Company's common stock at the date of grant. Expected stock volatility is based on historical volatilities of the SNL Financial Index of Thrifts. The expected life of the options is calculated based on the "simplified" method as provided for under generally accepted accounting principles.

The fiscal weighted-average fair value of options granted and assumptions used in the Black-Scholes-Merton option pricing model in the fiscal years granted are listed below:

	Fiscal Years Granted	
	2016	2015
Risk-free interest rate	1.67%	1.68%
Expected dividend yield	2.06%	2.00%
Expected stock volatility	16.1	15.9
Expected life (years)	8	8
Fair value	\$ 2.75	\$ 2.86

Stock options are assumed to be earned ratably over their respective vesting periods and charged to compensation expense based upon their grant date fair value and the number of options assumed to be earned. There were 44,414 and 43,313 options that were earned during the years ended June 30, 2016 and 2015, respectively. Stock-based

compensation expense for stock options for the years ended June 30, 2016 and 2015 was \$45 and \$46, respectively. Total unrecognized compensation cost related to nonvested stock options was \$125 at June 30, 2016 and is expected to be recognized over a weighted-average period of 2.5 years.

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## NOTE 15 — STOCK BASED COMPENSATION (Continued)

The following table summarizes non-vested restricted stock activity for the year ended June 30, 2016:

	June 30, 2016
Balance – beginning of year	62,502
Granted	7,000
Forfeited	(9,000)
Vested	(19,597)
Balance – end of period	40,905
Weighted average grant date fair value	\$ 13.52

The fair value of the restricted stock awards is amortized to compensation expense over their respective vesting periods and is based on the market price of the Company's common stock at the date of grant multiplied by the number of shares granted that are expected to vest. The weighted-average grant date fair value of restricted stock granted on January 23, 2015 was \$20.01 per share or \$252. The weighted-average grant date fair value of restricted stock granted on February 5, 2016 was \$19.40 per share or \$136. Total shares of restricted stock granted under the Plan is 119,294 of which 40,905 remain unvested at June 30, 2016. The weighted-average grant date fair value of all shares granted is \$13.52 per share. Stock-based compensation expense for restricted stock included in noninterest expense for the years ended June 30, 2016 and 2015 was \$243 and \$232, respectively. Unrecognized compensation expense for nonvested restricted stock awards was \$548 and is expected to be recognized over 3.4 years.

## NOTE 16 — LOAN SERVICING RIGHTS

Mortgage loans serviced for others are not reported as assets; however, the underlying mortgage servicing rights associated with servicing these mortgage loans serviced for others is recorded as an asset in the consolidated balance sheet.

The principal balances of those loans at June 30, 2016 and 2015 are as follows:

	June 30, 2016	June 30, 2015
Mortgage loan portfolio serviced for:		
FHLMC	\$ 125,812	\$ 141,195

Custodial escrow balances maintained in connection with serviced loans were \$1,007 and \$986 at June 30, 2016 and 2015, respectively.

	Years Ended	
	June 30, 2016	June 30, 2015
Loan servicing rights:		
Beginning of period:	\$ 1,396	\$ —
Additions	—	1,369
Change in fair value	(350)	27

End of period:           \$ 1,046     \$ 1,396

Fair value at June 30, 2016 was determined using a discount rate of 9.13%, prepayment speed assumptions ranging from 6.4% to 20.3% Conditional Prepayment Rate (“CPR”) depending on the loans coupon, term and seasoning, and a weighted average default rate of 0.61%. Fair value at June 30, 2015 was determined using a discount rate of 9.75%, prepayment speed assumptions ranging from 6.2% to 18.6% CPR depending on the loans’ coupon, term and seasoning, and a weighted average default rate of 0.66%.

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## NOTE 17 — SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information for the years ended June 30, 2016 and 2015 is as follows:

	June 30, 2016	June 30, 2015
Cash paid during the period for:		
Interest paid	\$ 1,190	\$ 1,219
Income taxes paid	\$ 682	\$ 1,520
Supplemental noncash disclosures:		
Transfers from loans to real estate owned	\$ 1,826	\$ 727
Acquisition:		
Assets acquired (excluding goodwill \$2,593)	\$ —	\$ 138,263
Liabilities assumed	\$ —	\$ 140,156
Acquisition price (common stock issued to OFED, MHC)	\$ —	\$ 700
Goodwill recorded	\$ —	\$ 2,593



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## NOTE 18 — PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

## CONDENSED BALANCE SHEETS

JUNE 30, 2016 AND 2015

	June 30, 2016	June 30, 2015
<b>ASSETS</b>		
Cash and cash equivalents	\$ 5,815	\$ 1,566
ESOP loan receivable	1,348	1,641
Other	127	822
Investment in banking subsidiary	78,723	77,124
Total assets	\$ 86,013	\$ 81,153
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Accounts payable and other liabilities	\$ 612	\$ 363
Shareholders' equity	85,401	80,790
Total liabilities and shareholders' equity	\$ 86,013	\$ 81,153

## CONDENSED STATEMENTS OF INCOME

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	June 30, 2016	June 30, 2015
Interest income	\$ 49	\$ 69
Other income	—	29
Dividend from banking subsidiary	6,882	—
Other expenses	(815)	(709)
Income before equity in undistributed income of subsidiary	6,116	(611)
Equity in undistributed income (losses) of subsidiary	(1,131)	4,915
Income before income taxes	4,985	4,304
Income tax benefit	(261)	(208)
Net income	\$ 5,246	\$ 4,512

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## NOTE 18 — PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	June 30, 2016	June 30, 2015
Cash Flows From Operating Activities		
Net income	\$ 5,246	\$ 4,512
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Change in other assets	695	(379)
Change in accounts payable and other liabilities	249	62
Undistributed (income) losses of subsidiary	1,131	(4,915)
Net cash provided by (used in) operations	7,321	(720)
Cash Flows From Investing Activities		
Payments received on ESOP loans	193	184
Maturities of available-for-sale securities	—	270
Net cash provided by investing activities	193	454
Cash Flows from Financing Activities		
Purchases of treasury shares	(1,013)	(35)
Dividends paid	(2,252)	(2,242)
Net cash used in financing activities	(3,265)	(2,277)
Change in cash and cash equivalents	4,249	(2,543)
Cash and cash equivalents, beginning of year	1,566	4,109
Cash and cash equivalents, end of year	\$ 5,815	\$ 1,566

## NOTE 19 — SUBSEQUENT EVENTS

On July 28, 2016, the Board of Directors of the Company declared a quarterly cash dividend of \$0.10 per share of the Company's common stock payable to stockholders of record as of August 11, 2016, which was paid on August 25, 2016.

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ITEM 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure  
None.

ITEM 9A. Controls and Procedures

(a)

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the fiscal year. Based upon that evaluation, the principal executive officer and principal financial officer concluded that, as of June 30, 2016, our disclosure controls and procedures were effective.

(b)

Management's Annual Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's system of internal control over financial reporting is designed under the supervision of management, including our Chief Executive Officer and Chief Financial Officer, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of the Company's consolidated financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles ("GAAP"). Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with GAAP, and that receipts and expenditures are made only in accordance with the authorization of management and the Board of Directors; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on our consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections on any evaluation of effectiveness to future periods are subject to the risk that the controls may become inadequate because of changes in conditions or that the degree of compliance with policies and procedures may deteriorate.

As of June 30, 2016, management assessed the effectiveness of the Company's internal control over financial reporting based upon the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based upon its assessment, management believes that the Company's internal control over financial reporting as of June 30, 2016 is effective using these criteria. This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company (as a smaller reporting company) to provide only management's report in this annual report.

(c)

Changes in Internal Control Over Financial Reporting

There were no significant changes made in our internal control over financial reporting during the Company's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. Other Information

Not applicable.

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## PART III

## ITEM 10. Directors, Executive Officers and Corporate Governance

The information contained under the sections captioned “Proposal I — Election of Directors — Directors,” “— Executive Officers Who Are Not Directors,” “— Section 16(a) Beneficial Ownership Reporting Compliance,” “— Code of Ethics” and “Meetings and Committees of the Board of Directors” in the Company’s definitive Proxy Statement for the 2016 Annual Meeting of Stockholders (the “Proxy Statement”) is incorporated herein by reference.

## ITEM 11. Executive Compensation

The information contained under the section captioned “Executive Compensation” in the Proxy Statement is incorporated herein by reference.

## ITEM 12.

## Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

## (a)

Securities Authorized for Issuance Under Stock-Based Compensation Plans. The following table sets forth information as of June 30, 2016 about Company common stock that may be issued under the Company’s equity compensation plans.

## EQUITY COMPENSATION PLAN INFORMATION

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under stock-based compensation
Equity compensation plans approved by security holders(1)	248,686	\$ 13.52	40,905
Total	248,686	\$ 13.52	40,905

## (1)

These awards were granted pursuant to the Oconee Federal Financial Corp. 2012 Equity Incentive Plan.

## (b)

Security Ownership of Certain Beneficial Owners. The information required by this item is incorporated herein by reference to the section captioned “Voting Securities and Principal Holders” in the Proxy Statement.

## (c)

Security Ownership of Management. The information required by this item is incorporated herein by reference to the section captioned “Proposal I — Election of Directors” in the Proxy Statement.

## (d)

Changes in Control. Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.

## ITEM 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated herein by reference to the section captioned “Proposal I — Election of Directors — Board Independence” and “— Transactions with Certain Related Persons” of the Proxy Statement.

ITEM 14. Principal Accounting Fees and Services

The information required by this item is incorporated herein by reference to the section captioned “Proposal II — Ratification of Appointment of Independent Registered Public Accounting Firm” of the Proxy Statement.

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PART IV

ITEM 15. Exhibits and Financial Statement Schedules

3.1	Charter of Oconee Federal Financial Corp.(1)
3.2	Bylaws of Oconee Federal Financial Corp.(2)
4	Form of Common Stock Certificate(1)
10.1	Form of Employee Stock Ownership Plan(1)
10.2	Non-Qualified Salary Continuation Agreement by and between Oconee Federal Savings and Loan Association and T. Rhett Evatt(1)
10.3	Deferred Compensation Agreement by and between Oconee Federal Savings and Loan Association and W. Maurice Poore(1)
10.4	Deferred Compensation Agreement by and between Oconee Federal Savings and Loan Association and Cecil T. Sandifer, Jr.(1)
10.5	Form of Employment Agreement by and between Oconee Federal Savings and Loan Association and T. Rhett Evatt(1)
10.6	Form of Employment Agreement by and between Oconee Federal Savings and Loan Association and Curtis T. Evatt(1)
10.7	Oconee Federal Savings and Loan Association Endorsement Split Dollar Life Insurance Plan for Curtis T. Evatt and Nancy M. Carter(3)
10.8	Oconee Federal Financial Corp. 2012 Equity Incentive Plan(4)
10.9	Separation Agreement and Full and Final Waiver, Release and Dismissal of all Claims among Oconee Federal Financial, Inc., Oconee Federal Savings and

	Loan Association, Oconee Federal, MHC and H. Allen Salter.(5)
21	Subsidiaries of Registrant(1)
23.1	Consent of Crowe Horwarth LLP
23.2	Consent of Cherry Bekaert LLP
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of June 30, 2016 and 2015, (ii) the Consolidated Statements of Income and Comprehensive Income for the years ended June 30, 2016 and 2015, (iii) the Consolidated Statements of Changes in Shareholders' Equity for the years ended June 30, 2016 and 2015, (iv) the Consolidated Statements of Cash Flows for the years ended June 30, 2016 and 2015, and (v) the Notes to the Consolidated Financial Statements.

(1)  
 Incorporated by reference to the Registration Statement on Form S-1 (File No. 333-169419), as initially filed September 16, 2010, and as subsequently amended.

(2)  
Incorporated by reference to the current report on Form 8-K (File No. 001-35033), filed on April 26, 2013.

(3)  
Incorporated by reference to the current report on Form 8-K (File No. 001-35033), filed on June 28, 2013.

(4)  
Incorporated by reference to the proxy statement for the special meeting of stockholders (File No. 001-35033), filed February 23, 2012.

(5)  
Incorporated by reference to the current report on Form 8-K (File No. 001-35033), filed on March 24, 2016.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OCONEE FEDERAL FINANCIAL CORP.

Date: September 28, 2016 By: /s/ T. RHETT EVATT

T. Rhett Evatt  
 Chief Executive Officer and Chairman  
 (Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ T. RHETT EVATT T. Rhett Evatt	Chief Executive Officer and Chairman of the Board (Principal Executive Officer)	September 28, 2016
/s/ CURTIS T. EVATT Curtis T. Evatt	President, Chief Financial Officer and Director (Principal Financial Officer)	September 28, 2016
/s/ HARRY B. MAYS, JR. Harry B. Mays, Jr.	Director	September 28, 2016
/s/ ROBERT N. MCLELLAN, JR. Robert N. McLellan, Jr.	Director	September 28, 2016
/s/ W. MAURICE POORE W. Maurice Poore	Director	September 28, 2016
/s/ CECIL T. SANDIFER, JR. Cecil T. Sandifer, Jr.	Director	September 28, 2016