Coastway Bancorp, Inc.
Form 10-Q
August 02, 2018
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

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

**or**

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

**FOR THE TRANSITION PERIOD FROM TO .**

**For the quarterly period ended June 30, 2018**

**Commission File Number: 001-36263**

# Coastway Bancorp, Inc.

(Exact name of registrant as specified in its charter)

| **Maryland** | **46-4149994** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **One Coastway Blvd, Warwick, Rhode Island** | **02886** |
| (Address of principal executive offices) | (Zip code) |

**(401) 330-1600**

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) x Yes o No

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

| | | | |
|---|---|---|---|
| Large accelerated filer | o | Accelerated filer | x |
| Non-accelerated filer | o | (Do not check if a smaller reporting company) | |
| | | Smaller reporting company | o |
| | | Emerging growth company | x |

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

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

As of **July 31, 2018** there were **4,386,351** shares of the issuer s common stock outstanding- par value $0.01 per share

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**COASTWAY BANCORP, INC. and SUBSIDIARY**

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**PART I-FINANCIAL INFORMATION**

## Item 1 - Financial Statements

**COASTWAY BANCORP, INC. and SUBSIDIARY**

Consolidated Balance Sheets

(Unaudited)

| (Dollars in thousands except per share amounts) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| *Assets* | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | $ 2,435 | $ 3,258 |
| Interest-earning deposits | 47,649 | 51,311 |
| Total cash and cash equivalents | 50,084 | 54,569 |
| Federal Home Loan Bank stock, at cost | 11,368 | 8,299 |
| Loans, net of allowance for loan losses of $3,358 and $2,920, respectively | 708,755 | 614,593 |
| Loans held for sale | 16,238 | 11,077 |
| Premises and equipment, net | 31,204 | 31,849 |
| Accrued interest receivable | 2,267 | 1,962 |
| Foreclosed real estate | | 4,223 |
| Bank-owned life insurance | 4,646 | 4,585 |
| Net deferred tax asset | 1,049 | 1,047 |
| Other assets | 9,293 | 6,701 |
| Total assets | $ 834,904 | $ 738,905 |
| | | |
| *Liabilities and Stockholders Equity* | | |
| Deposits: | | |
| Interest-bearing | $ 368,031 | $ 360,068 |
| Non-interest-bearing | 133,913 | 116,888 |
| Total deposits | 501,944 | 476,956 |
| Borrowed funds | 250,950 | 181,675 |
| Accrued expenses and other liabilities | 8,580 | 8,929 |
| Total liabilities | 761,474 | 667,560 |
| | | |
| Commitments and contingencies (Note 6) | | |
| Stockholders equity: | | |
| Preferred stock, $0.01 par value; 20,000,000 shares authorized, none issued or outstanding at June 30, 2018 and December 31, 2017 | | |
| Common stock, $0.01 par value; 50,000,000 shares authorized; 4,386,351 and 4,389,045 issued and outstanding at June 30, 2018 and December 31, 2017, respectively | 44 | 44 |
| Additional paid-in capital | 40,217 | 40,065 |
| Retained earnings | 36,688 | 34,834 |
| Unearned compensation - Employee Stock Ownership Plan (ESOP) | (3,248) | (3,327) |
| Accumulated other comprehensive loss | (271) | (271) |
| Total stockholders equity | 73,430 | 71,345 |

| | | | | |
|---|---|---|---|---|
| | $ | 834,904 | $ | 738,905 |

The accompanying notes are an integral part of the consolidated unaudited financial statements.

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**COASTWAY BANCORP, INC. and SUBSIDIARY**

Consolidated Statements of Net Income and Comprehensive Income

(Unaudited)

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| **(in thousands except share amounts)** | **2018** | **2017** | **2018** | **2017** |
| Interest income: | | | | |
| Interest and fees on loans | $ 7,426 | $ 5,706 | $ 14,114 | $ 11,169 |
| Other interest income | 305 | 153 | 550 | 303 |
| Total interest income | 7,731 | 5,859 | 14,664 | 11,472 |
| Interest expense: | | | | |
| Interest on deposits | 814 | 733 | 1,621 | 1,439 |
| Interest on borrowed funds | 1,162 | 290 | 1,936 | 516 |
| Total interest expense | 1,976 | 1,023 | 3,557 | 1,955 |
| Net interest income | 5,755 | 4,836 | 11,107 | 9,517 |
| Provision for loan losses | 207 | 153 | 569 | 213 |
| Net interest income after provision for loan losses | 5,548 | 4,683 | 10,538 | 9,304 |
| Non-interest income: | | | | |
| Customer service fees | 950 | 868 | 1,847 | 1,700 |
| Net gain on sales of loans and other mortgage banking income | 1,011 | 1,025 | 1,635 | 1,843 |
| Bank-owned life insurance income | 31 | 32 | 61 | 70 |
| Other income | 34 | 48 | 27 | 108 |
| Total non-interest income | 2,026 | 1,973 | 3,570 | 3,721 |
| Non-interest expenses: | | | | |
| Salary and employee benefits | 2,900 | 2,991 | 5,799 | 5,950 |
| Occupancy and equipment | 751 | 795 | 1,575 | 1,665 |
| Data processing | 489 | 481 | 968 | 955 |
| Professional fees | 478 | 178 | 1,095 | 400 |
| Deposit servicing | 232 | 235 | 468 | 476 |
| FDIC insurance assessment | 122 | 73 | 232 | 152 |
| Advertising | 63 | 92 | 142 | 193 |
| Foreclosed real estate | 17 | 7 | 88 | 14 |
| Other general and administrative | 477 | 431 | 977 | 923 |
| Total non-interest expenses | 5,529 | 5,283 | 11,344 | 10,728 |
| Income before income taxes | 2,045 | 1,373 | 2,764 | 2,297 |
| Income tax expense | 638 | 556 | 910 | 918 |
| Net income and comprehensive income | $ 1,407 | $ 817 | $ 1,854 | $ 1,379 |
| Weighted average common shares outstanding-basic | 4,030,306 | 4,002,657 | 4,026,715 | 4,008,281 |
| Weighted average common shares outstanding-diluted | 4,096,031 | 4,028,360 | 4,087,301 | 4,030,141 |
| Per share information: | | | | |
| Basic earnings per common share | $ 0.35 | $ 0.20 | $ 0.46 | $ 0.34 |
| Diluted earnings per common share | $ 0.34 | $ 0.20 | $ 0.45 | $ 0.34 |

The accompanying notes are an integral part of the consolidated unaudited financial statements.

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**COASTWAY BANCORP, INC. and SUBSIDIARY**

Consolidated Statement of Changes in Stockholders Equity

Six months ended June 30, 2018

(Unaudited)

| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Unearned Compensation-ESOP | Accumulated Other Comprehensive Loss | Total Stockholders Equity |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | | |
| | | | | (Dollars in thousands) | | | |
| Balance at December 31, 2017 | 4,389,045 | $ 44 | $ 40,065 | $ 34,834 | $ (3,327) | $ (271) | $ 71,345 |
| Net income | | | | 1,854 | | | 1,854 |
| Stock-based compensation, net of awards surrendered | (2,694) | | 32 | | | | 32 |
| ESOP shares committed to be allocated (7,918 shares) | | | 120 | | 79 | | 199 |
| Balance at June 30, 2018 | 4,386,351 | $ 44 | $ 40,217 | $ 36,688 | $ (3,248) | $ (271) | $ 73,430 |

The accompanying notes are an integral part of the consolidated unaudited financial statements.

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**COASTWAY BANCORP, INC. and SUBSIDIARY**

Consolidated Statements of Cash Flows

(Unaudited)

| (Dollars in thousands) | Six months ended June 30, 2018 | 2017 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 1,854 | $ 1,379 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 569 | 213 |
| Loans originated for sale | (84,890) | (95,253) |
| Loans sold | 80,835 | 107,172 |
| Gain on sale of mortgage loans, net | (1,106) | (1,990) |
| Amortization of deferred loan costs | 559 | 493 |
| Provision on foreclosed real estate | 9 | |
| Depreciation and amortization expense | 731 | 719 |
| Income from Bank-owned life insurance | (61) | (70) |
| Deferred income tax expense (benefit) | (2) | (134) |
| ESOP expense | 199 | 145 |
| Stock-based compensation | 91 | 93 |
| Net change in: | | |
| Accrued interest receivable | (305) | (118) |
| Other, net | (2,929) | (1,812) |
| Net cash provided (used) by operating activities | (4,446) | 10,837 |
| Cash flows from investing activities: | | |
| Purchase of FHLB stock | (3,069) | (826) |
| Redemption of FHLB stock | | 838 |
| Loan originations, net of principal payments | (29,984) | (25,124) |
| Purchase of loans from third party originators | (65,306) | (13,273) |
| Purchases of premises and equipment | (86) | (977) |
| Proceeds from sale of foreclosed real estate | 4,202 | |
| Net cash used by investing activities | (94,243) | (39,362) |
| Cash flows from financing activities: | | |
| Net increase in deposits | 24,988 | 24,053 |
| Net change in short-term borrowed funds | 69,275 | 6,691 |
| Restricted stock forfeited for tax withholdings | (59) | (44) |
| Repurchase of common stock | | (333) |
| Net cash provided by financing activities | 94,204 | 30,367 |
| | | |
| Net change in cash and cash equivalents | (4,485) | 1,842 |
| Cash and cash equivalents at beginning of period | 54,569 | 44,658 |
| Cash and cash equivalents at end of period | $ 50,084 | $ 46,500 |
| | | |
| Supplemental cash flow information: | | |
| Interest paid on deposits | $ 1,620 | $ 1,438 |
| Interest paid on borrowed funds | 1,871 | 515 |
| Income taxes paid | 350 | 1,741 |

The accompanying notes are an integral part of the consolidated unaudited financial statements.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements

## (1) Basis of Presentation and Consolidation

*General information*

Coastway Bancorp, Inc., a Maryland chartered stock corporation ( Company or Corporation ), was formed to serve as the holding company for Coastway Community Bank. Coastway Community Bank (the Bank ) is a Rhode Island-chartered savings bank. The Bank provides a variety of financial services to individuals and small businesses throughout Rhode Island. Its primary deposit products are savings, demand, money market and term certificate accounts and its primary lending products are one-to four-family residential mortgage loans, home equity loans and lines of credit, commercial real estate and SBA loans.

*Acquisition*

On March 14, 2018, the Company and HarborOne Bancorp, Inc. ( HONE ) announced they had entered into a definitive agreement ( Merger Agreement ) under which HONE will acquire the Company in an all cash transaction valued at approximately $125.6 million. The Company s stockholders will receive $28.25 for each share of Company common stock that they own. The transaction is expected to close in the second half of 2018 and is subject to customary closing conditions, including required regulatory approvals. On June 21, 2018, the Corporation s stockholders approved and adopted the Merger Agreement. However, it is possible that factors outside the control of both companies, including whether or when the required regulatory approvals will be received, could result in the merger being delayed or not completed at all. In connection with the merger, the Company had incurred $278,000 and $676,000 of merger expenses for the three and six months ended June 30, 2018, primarily legal and investment banker costs, which are included in professional fees in the Statements of Net Income and Comprehensive income.

*Basis of Presentation*

The consolidated financial statements include the accounts of the Corporation and its subsidiary. In June 2018, Rhode Island Passive Investment Corp. was formed which is a wholly-owned subsidiary of the Bank. All significant intercompany transactions have been eliminated. The unaudited consolidated financial statements of the Corporation presented herein have been prepared in accordance with U.S. Generally Accepted Accounting Principles ( GAAP ) for interim financial information and pursuant to the rules of the SEC for quarterly reports on Form 10-Q and Regulation S-X and do not include all of the information and note disclosures required by GAAP for a complete set of financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures necessary for the fair presentation of the accompanying consolidated financial statements have been included. The results of operations for interim periods are not necessarily indicative of results for the full year or any other interim period. The accompanying unaudited financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2017, included in the Corporation s annual report on Form 10-K.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of deferred tax assets, the valuation of loans held for sale, mortgage-banking derivatives and commitments to sell fixed-rate residential mortgages.

*Stock-Based Compensation*

Compensation cost is recognized for stock options and restricted stock awards issued to employees based on the fair value of these awards at the grant date. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Corporation s stock at the grant date is utilized for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

*Income Taxes*

The Tax Cuts and Jobs Act (the Tax Act ) was signed into law in December 2017 which reduced the corporate federal statutory tax rate from 34% to 21% effective January 1, 2018.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

*Recent Accounting Pronouncements*

As an emerging growth company as defined in Title 1 of the Jumpstart Our Business Startups (JOBS) Act, the Corporation has elected to use the extended transition period to delay the adoption of new or reissued accounting pronouncements applicable to public companies until such pronouncements are made applicable to private companies. In June 2018, the SEC revised the definition of smaller reporting company to include companies with public float of less than $250 million, an increase from the prior $75 million threshold. This revised rule has not yet taken effect.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. The objective of this amendment is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS. This update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are in the scope of other standards. In August 2015, the FASB issued ASU 2015-14 to defer for one year the effective date of the new revenue standard. The requirements are effective for annual periods and interim periods within fiscal years beginning after December 15, 2018. During 2016, the FASB issued further implementation guidance regarding revenue recognition. This additional guidance included clarification on certain principal versus agent considerations within the implementation of the guidance as well as clarification related to identifying performance obligations and licensing, assessing collectability, presenting sales taxes, measuring noncash consideration, and certain transition matters. The Corporation s largest sources of income is net interest income on financial assets and liabilities and net gain on sales of loans and other mortgage banking income, which are explicitly excluded from the scope of this ASU. Accordingly the majority of our revenues will not be affected. The Corporation does not expect the adoption of this guidance will have a significant impact on the Corporation s consolidated financial statements, but is expected to require additional disclosures.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* (Subtopic 825-10), which addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The ASU requires equity instruments (except those accounted for under the equity method of accounting or that result in consolidations of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure an equity investment that does not have a readily determinable fair value at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions. For public business entities, the standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, including emerging growth companies, the standard is effective for fiscal years beginning after December 15, 2018 and interim periods within fiscal periods after December 15, 2019. We do not expect a significant impact upon adoption on January 1, 2019.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which will require organizations that lease assets referred to as lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Under the new guidance, a lessee will be required to recognize right to use assets and lease liabilities for leases with lease terms of more than 12 months. However, unlike current Generally Accepted Accounting Principles (GAAP) which requires only capital leases to be recognized on the balance sheet the new ASU will require both types of leases to be recognized on the balance sheet. The accounting by organizations that own the assets leased by the lessee also known as lessor accounting will remain largely unchanged from current GAAP. However, the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model. The ASU on leases will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other organizations, including emerging growth companies, the ASU on leases will take effect for fiscal years beginning after December 15, 2019, and for interim

periods within fiscal years beginning after December 15, 2020. We are currently evaluating the impact of adoption of this standard, including identifying contracts that are, or contain, leases, as the lease identification guidance in the new standard is different than the current standard.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments Credit Losses*, that will significantly change how banks measure and recognize credit impairment for many financial assets from an incurred loss methodology to a current expected credit loss model. The current expected credit loss model will require companies to immediately recognize an estimate of credit losses expected to occur over the remaining life of the financial assets that are in the scope of the standard. The FASB also made targeted amendments to the current impairment model for available-for-sale debt securities. The ASU is effective for public business entities that are SEC filers, for annual and interim periods in fiscal years beginning after December 15, 2019, and for other companies, including emerging growth companies, for interim and annual periods in fiscal years beginning after December 15, 2020. All entities may early adopt the standard for annual and interim periods in fiscal years after December 15, 2018. The standard will be effective for the Corporation on January 1, 2020. We are currently evaluating the impact of adoption of this standard, including different methodologies that may be employed to estimate credit losses, such as loss rate methods, component loss methods, and qualitative factors, as well as additional data gathering that will be needed to

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

adopt the standard. The standard will add new disclosures related to factors that influenced management s estimate, including current expected credit losses, the changes in those factors, and reasons for the changes as well as the method applied to revert to historical credit loss experience.

ASU 2017-07, Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost which in March 2017, the FASB issued amended existing guidance to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amendments require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit costs are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. The amendments allow only the service cost component to be eligible for capitalization. The amendments are effective for public business entities for annual periods beginning after December 15, 2017, including interim periods within those periods. For emerging growth companies, the amendments are effective for annual periods after December 15, 2018, including interim periods within those periods. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. The amendments should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the statement of net income and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The amendments allow a practical expedient that permits an employer to use the amounts disclosed in its pension and other postretirement benefit plan note for the prior comparative periods as the estimation basis for applying the retroactive presentation requirements. The amendment requires disclosure that the practical expedient was used. The adoption of this standard is not expected to have a material effect on the Company s operating results or financial condition.

## (2) Loans

Major classifications of loans at the dates indicated, are as follows:

| (Dollars in thousands) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Residential real estate mortgage loans: | | |
| 1-4 family | $ 395,185 | $ 312,095 |
| Home equity loans and lines of credit | 68,561 | 71,844 |
| Total residential real estate mortgage loans | 463,746 | 383,939 |
| | | |
| Commercial: | | |
| Commercial real estate | 173,978 | 156,024 |
| Commercial business | 13,984 | 17,158 |
| Commercial construction | 13,262 | 13,552 |
| SBA | 40,533 | 41,020 |
| Consumer | 1,215 | 1,229 |
| Total loans | 706,718 | 612,922 |
| | | |
| Allowance for loan losses | (3,358) | (2,920) |

| | | | | |
|---|---|---|---|---|
| Net deferred loan costs | | 5,395 | | 4,591 |
| Loans, net | $ | 708,755 | $ | 614,593 |

Residential one- to four-family loans of $395.2 million at June 30, 2018 and $312.1 million at December 31, 2017 include purchased loans which were individually underwritten based on the Bank s credit standards, totaling $151.5 million and $96.8 million at June 30, 2018 and December 31, 2017, respectively. During the six months ended June 30, 2018 and 2017, the Bank purchased $64.5 million and $13.1 million of loans at a cost of $65.3 million and $13.3 million, respectively. The loans purchased from third parties are located in New England, primarily Massachusetts.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Loan Segments**

One-to four-family residential real estate and home equity    Loans in these segments are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The Bank generally has first liens on one-to four-family residential real estate loans and first or second liens on property securing home equity loans and equity lines-of-credit. Jumbo one- to four-family loans generally have maximum loan-to-value ratios of 95%. Loan-to-value ratios of one- to four-family loans without private mortgage insurance may be made with loan-to-value ratios up to 95%. Home equity loans and lines of credit may be underwritten with a loan-to-value ratio up to 80%. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in these segments.

Commercial    Commercial loan segments include commercial real estate, commercial and industrial loans for businesses and construction financing for business/properties located principally in Rhode Island. For commercial real estate loans, the underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Non-real estate commercial loans are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. Commercial construction generally represent loans to finance construction of retail and office space. Commercial loans also include loans made under the SBA 504 program which is an economic development program that finances the expansion of small businesses. The Bank generally provides 50% of the projected costs, and the loan is secured by a first lien on the commercial property. The SBA does not provide a guarantee on loans made under the SBA 504 program. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment. Management monitors the cash flows of these loans.

SBA    Loans in this segment include commercial loans underwritten using SBA guidelines for the SBA  s 7(a) program and include both guaranteed and unguaranteed portions of the same loans. Currently, under the SBA 7(a) program, loans may qualify for guarantees up to 85% of principal and accrued interest up to a maximum SBA guarantee of $3.75 million per borrower and related entities. The Bank does not treat the SBA guarantee as a substitute for a borrower meeting reasonable credit standards. SBA guarantees are generally sought on loans to borrowers that exhibit minimum capital levels, a short time in business, lower collateral coverage or maximum loan terms beyond the Bank  s normal underwriting criteria. For a number of SBA loans, the Bank has sold portions of certain loans and retains the unguaranteed portion while continuing to service the entire loan. The guaranteed portion of SBA loans in the Bank  s portfolio is not allocated a general reserve because the Bank has not experienced losses on such loans and management expects the guarantees will be effective, if necessary. Guaranteed portions of SBA loans totaled $26.6 million and $26.7 million at June 30, 2018 and December 31, 2017, respectively.

Consumer    This segment includes unsecured and vehicle loans and repayment is dependent on the credit quality of the individual borrower. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

**Allowance for Loan Losses**

***Allowance for Loan Loss Methodology***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. For impaired loans that are deemed collateral dependent, the recorded balance of the loan is reduced by a charge-off to fair value of the collateral net of estimated selling costs.

The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of general and specific components as described below.

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by loan segments. Management uses a ten year historical loss period to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; charge-off trends over the past three and five year periods; weighted average risk ratings; loan concentrations; management s assessment of internal factors; and management s assessment of external factors such as interest rates, real estate markets and local and national economic factors. There were no changes in the Bank s policies or methodology pertaining to the general component of the allowance for loan losses during the three and six months ended June 30, 2018 and the year ended December 31, 2017.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

The Corporation evaluates the need for 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 less estimated selling expenses. Factors in identifying a specific problem loan and the need for a specific allowance include: (1) the strength of the customer s personal or business cash flows; (2) the availability of other sources of repayment; (3) the amount due or past due; (4) the type and value of collateral; (5) the strength of the collateral position; (6) the estimated cost to sell the collateral; and (7) the borrower s effort to cure the delinquency.

In addition, for loans secured by real estate, the Corporation considers the extent of any past due and unpaid property taxes applicable to the property serving as collateral on the mortgage when evaluating the need for a specific allowance on loans determined to be impaired.

***Credit Quality Indicators***

Commercial and SBA loans are risk rated based on key factors such as management ability, financial condition, debt repayment ability, collateral, industry conditions and loan structure.

Risk Rating 6 Special Mention: these loans have potential weaknesses and require management s close attention. If these weaknesses are not addressed, they may weaken the prospects for repayment at a future date. Special mention assets do not expose the institution to sufficient risk to warrant a classified rating.

Risk Rating 7 Substandard: loans in this category are inadequately protected by the current financial condition and repayment ability of the borrower or pledged collateral, if any. These assets have a well-defined weakness(es) that jeopardizes the repayment of the debt in full, and are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Risk Rating 8 Doubtful: loans have all the weaknesses of those classified substandard. In addition, it is highly unlikely that a doubtful asset can be collected or liquidated in full. The possibility of loss is extremely high. However, because of certain important and reasonably specific pending factors, which may work to strengthen the asset, its classification as a loss is deferred until the asset s status can be better determined.

Risk Rating 9 Loss: loans classified as loss are considered uncollectible and of such little value that they are no longer considered bankable. This classification does not mean that the asset has no recovery or salvage value. However, it is not practical or desirable to defer writing off the asset even though partial recovery may occur in the future.

Loans not meeting the criteria above that are analyzed individually as part of the above process are considered to be pass-rated.

On an annual basis, or more often if needed, the Bank formally reviews the ratings on commercial and SBA loans over $250,000. On an annual basis, the Bank engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review of its control process related to loan ratings. Credit quality for residential real estate mortgage and consumer loans is determined by monitoring loan payment history and on-going communications with borrowers, and are not risk graded. Non-performing homogenous loans are individually evaluated for impairment. The following table presents the credit risk profile by internally assigned risk rating category at the dates indicated:

| | June 30, 2018 | | | | |
|---|---|---|---|---|---|
| **(Dollars in thousands)** | **Commercial Real Estate** | **Commercial Business** | **Commercial Construction** | **SBA** | **Total** |
| Pass | $ 170,330 | $ 13,984 | $ 13,262 | $ 39,542 | $ 237,118 |
| Loans rated 6 | | | | 47 | 47 |
| Loans rated 7 | 3,648 | | | 819 | 4,467 |
| Loans rated 8 | | | | 125 | 125 |
| | $ 173,978 | $ 13,984 | $ 13,262 | $ 40,533 | $ 241,757 |

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Total |
| Pass | $ 152,296 | $ 17,158 | $ 13,552 | $ 39,040 | $ 222,046 |
| Loans rated 6 | | | | 76 | 76 |
| Loans rated 7 | 3,728 | | | 1,904 | 5,632 |
| Loans rated 8 | | | | | |
| | $ 156,024 | $ 17,158 | $ 13,552 | $ 41,020 | $ 227,754 |

***Past Due and Non-Accrual Loans***

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the loan is both well secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual at an earlier date if collection of principal or interest is considered doubtful. All interest accrued, but not collected for loans that are placed on non-accrual, is reversed against interest income. The interest on these 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, the loan has performed in accordance with the contractual terms for a reasonable period of time, typically a minimum of six months and future payments are reasonably assured.

The following table presents past due loans as of the dates indicated.

**June 30, 2018**

| (Dollars in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Past Due > 90 Days and Still Accruing | Loans on Non-accrual |
|---|---|---|---|---|---|---|
| Residential real estate: | | | | | | |
| 1-4 family | $ 728 | $ | $ 310 | $ 1,038 | $ | $ 2,966 |
| Home equity loans and lines of credit | 794 | 220 | 61 | 1,075 | | 701 |
| Commercial real estate | | | 254 | 254 | | 254 |
| Commercial business | | 17 | | 17 | | |
| Commercial construction | | | | | | |
| SBA | | | 261 | 261 | | 347 |
| Consumer | | | | | | |
| Total gross loans | $ 1,522 | $ 237 | $ 886 | $ 2,645 | $ | $ 4,268 |

**December 31, 2017**

| (Dollars in thousands) | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Past Due > 90 Days and Still Accruing | Loans on Non-accrual |
|---|---|---|---|---|---|---|
| Residential real estate: | | | | | | |
| 1-4 family | $ 4,337 | $ 237 | $ 531 | $ 5,105 | $ | $ 3,385 |
| Home equity loans and lines of credit | 611 | 100 | 132 | 843 | | 573 |
| Commercial real estate | 1,404 | 376 | 254 | 2,034 | | 254 |
| Commercial business | | 32 | | 32 | | |
| Commercial construction | | | | | | |
| SBA | 1,079 | 179 | 281 | 1,539 | | 524 |
| Consumer | 11 | | | 11 | | |
| Total gross loans | $ 7,442 | $ 924 | $ 1,198 | $ 9,564 | $ | $ 4,736 |

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

The balance of loans on non-accrual at June 30, 2018 and December 31, 2017 exceeds loans 90 days or more past due, due to a combination of loans that are current, but that have been modified in a troubled debt restructuring and/or loans for which future payments are not reasonably assured.

***Impaired Loans***

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The Bank periodically may agree to modify the contractual terms of loans, such as a reduction in interest rate of the loan for some period of time, an extension of the maturity date or an extension of time to make payments with the delinquent payments added to the end of the loan term. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ( TDR ). All TDRs are classified as impaired. Loans on non-accrual status at the date of modification are initially classified as non-accruing troubled debt restructurings. TDRs may be returned to accrual status after a period of satisfactory payment performance according to the terms of the restructuring, generally six months of current payments.

The following tables set forth the recorded investment in impaired loans and the related specific allowance allocated as of the dates indicated.

**June 30, 2018**

| (Dollars in thousands) | Unpaid contractual principal balance | Total recorded investment in impaired loans | Recorded investment with no allowance | Recorded investment with allowance | Related allowance |
|---|---|---|---|---|---|
| Residential real estate: | | | | | |
| 1-4 family | $ 4,941 | $ 4,682 | $ 4,367 | $ 315 | $ 5 |
| Home equity loans & lines of credit | 1,873 | 1,832 | 1,795 | 37 | 6 |
| Commercial real estate | 465 | 465 | 465 | | |
| SBA | 2,175 | 2,025 | 2,025 | | |
| Consumer | 119 | 119 | 41 | 78 | 13 |

| Total | $ | 9,573 | $ | 9,123 | $ | 8,693 | $ | 430 | $ | 24 |
|---|---|---|---|---|---|---|---|---|---|---|

**December 31, 2017**

| (Dollars in thousands) | | Unpaid contractual principal balance | | Total recorded investment in impaired loans | | Recorded investment with no allowance | | Recorded investment with allowance | | Related allowance |
|---|---|---|---|---|---|---|---|---|---|---|
| Residential real estate: | | | | | | | | | | |
| 1-4 family | $ | 5,382 | $ | 5,125 | $ | 4,810 | $ | 314 | $ | 6 |
| Home equity loans & lines of credit | | 1,888 | | 1,845 | | 1,807 | | 39 | | 6 |
| Commercial real estate | | 475 | | 476 | | 475 | | | | |
| SBA | | 2,660 | | 2,640 | | 2,492 | | 149 | | 8 |
| Consumer | | 55 | | 55 | | 43 | | 12 | | 2 |
| Total | $ | 10,460 | $ | 10,141 | $ | 9,627 | $ | 514 | $ | 22 |

Of the $2.0 million and $2.6 million of impaired SBA loans at June 30, 2018 and at December 31, 2017, respectively, guaranteed portions of such loans amounted to $1.6 million and $1.9 million at June 30, 2018 and December 31, 2017, respectively.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

The following table presents the average recorded investment in impaired loans and the related interest recognized during the periods indicated.

| | Three Months Ended June 30, 2018 | | Three Months Ended June 30, 2017 | |
|---|---|---|---|---|
| **(Dollars in thousands)** | **Average recorded investment** | **Interest income recognized** | **Average recorded investment** | **Interest income recognized** |
| Residential 1-4 family | $ 4,584 | $ 54 | $ 4,742 | $ 69 |
| Home equity loans & lines of credit | 1,827 | 24 | 1,854 | 25 |
| Commercial real estate | 467 | 2 | 4,411 | 52 |
| SBA | 2,341 | 29 | 1,606 | 22 |
| Consumer | 103 | 1 | 24 | |
| Total | $ 9,322 | $ 110 | $ 12,637 | $ 168 |

| | Six Months Ended June 30, 2018 | | Six Months Ended June 30, 2017 | |
|---|---|---|---|---|
| **(Dollars in thousands)** | **Average recorded investment** | **Interest income recognized** | **Average recorded investment** | **Interest income recognized** |
| Residential 1-4 family | $ 4,795 | $ 126 | $ 5,115 | $ 122 |
| Home equity loans & lines of credit | 1,829 | 54 | 1,759 | 50 |
| Commercial real estate | 470 | 5 | 4,405 | 100 |
| SBA | 2,461 | 57 | 1,550 | 46 |
| Consumer | 82 | 1 | 19 | |
| Total | $ 9,637 | $ 243 | $ 12,848 | $ 318 |

***Troubled Debt Restructurings***

Loans are designated as a TDR when, as part of an agreement to modify the original contractual terms of the loan, the Bank grants a concession on the terms, that would not otherwise be considered, as a result of financial difficulties of the borrower. Typically, such concessions may consist of a reduction in interest rate to a below market rate, taking into account the credit quality of the note, or a deferment or reduction of payments, principal or interest, which materially alters the Bank s position or significantly extends the note s maturity date, such that the present value of cash flows to be received is materially less than those contractually established at the loan s origination. All loans that are modified are reviewed by the Bank to identify if a TDR has occurred. TDRs are included in the impaired loan category and as such, these loans are individually evaluated for impairment and a specific reserve is assigned for the amount of the estimated credit loss. Total TDR loans, included in impaired loans as of June 30, 2018 and December 31, 2017 were $7.4 million and $8.2 million, respectively. No additional funds are committed to be advanced in connection with TDR loans. TDR loans on accrual status amounted to $4.9 million and $5.4 million at June 30, 2018 and December 31, 2017, respectively.

Troubled debt restructuring agreements entered into during the period indicated are as follows:

| | Three Months Ended June 30, 2018 | | | Six Months Ended June 30, 2018 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Number of restructurings | Pre-modification outstanding recorded investment | Post-modification outstanding recorded investment | Number of restructurings | Pre-modification outstanding recorded investment | Post-modification outstanding recorded investment |
| Residential 1-4 family | | $ | $ | 1 | $ 155 | $ 155 |
| Home equity | 1 | 67 | 56 | 2 | 83 | 72 |
| Commercial real estate | | | | | | |
| SBA | | | | | | |
| Consumer | | | | | | |
| Total | 1 | $ 67 | $ 56 | 3 | $ 238 | $ 227 |

The troubled debt restructurings described above had a $11,000 impact to the allowance for loan losses and resulted in no charge-offs during the three and six months ended June 30, 2018.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

There were no troubled debt restructurings that subsequently defaulted within 12 months of restructuring during the three and six months ended June 30, 2018.

Troubled debt restructuring agreements entered into during the period indicated are as follows:

| | Three Months Ended June 30, 2017 | | | Six Months Ended June 30, 2017 | | |
|---|---|---|---|---|---|---|
| **(Dollars in thousands)** | **Number of TDRs that defaulted** | | **Pre and Post-modification outstanding recorded** | **Number of TDRs that defaulted** | | **Pre and Post-modification outstanding recorded** |
| Residential 1-4 family | | $ | | | $ | |
| Home equity | 2 | | 255 | 6 | | 654 |
| Commercial real estate | 1 | | 259 | 1 | | 259 |
| SBA | 1 | | 250 | 1 | | 250 |
| Consumer | 1 | | 44 | 1 | | 44 |
| Total | 5 | $ | 808 | 9 | $ | 1,207 |

The troubled debt restructurings described above had no impact to the allowance for loan losses and resulted in no charge-offs during the three and six months ended June 30, 2017.

Troubled debt restructurings that subsequently defaulted within 12 months of restructuring are as follows during the period indicated:

| | Three Months Ended June 30, 2017 | | | Six Months Ended June 30, 2017 | | |
|---|---|---|---|---|---|---|
| **(Dollars in thousands)** | **Number of TDRs that defaulted** | | **Post-modification outstanding recorded investment** | **Number of TDRs that defaulted** | | **Post-modification outstanding recorded investment** |
| Residential 1-4 family | 1 | $ | 71 | 1 | $ | 71 |
| Home equity | | | | 1 | | 74 |
| Commercial real estate | | | | 2 | | 4,108 |
| SBA | | | | | | |
| Total | 1 | $ | 71 | 4 | $ | 4,253 |

The troubled debt restructurings described above resulted in no charge-offs and no specific reserves for the three and six months ended June 30, 2017.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Allowance for loan loss activity**

Changes in the allowance for loan losses by segment are presented below:

Three Months Ended June 30, 2018

| (Dollars in thousands) | Residential 1-4 family | Home Equity | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| Allowance at March 31, 2018 | $ 1,416 | $ 477 | $ 845 | $ 81 | $ 82 | $ 255 | $ 6 | $ 3,162 |
| Provision (credit) | 193 | (14) | 52 | (10) | (10) | (13) | 9 | 207 |
| Loans charged-off | | | | | | (15) | | (15) |
| Recoveries | | 1 | | | | 1 | 2 | 4 |
| Allowance at June 30, 2018 | $ 1,609 | $ 464 | $ 897 | $ 71 | $ 72 | $ 228 | $ 17 | $ 3.358 |

Three Months Ended June 30, 2017

| (Dollars in thousands) | Residential 1-4 family | Home Equity | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| Allowance at March 31, 2017 | $ 1,033 | $ 533 | $ 629 | $ 64 | $ 61 | $ 231 | $ 8 | $ 2,559 |
| Provision (credit) | 54 | (11) | 63 | 5 | 8 | 42 | (8) | 153 |
| Loans charged-off | (6) | | | | | | | (6) |
| Recoveries | 6 | 1 | | | | | 7 | 14 |
| Allowance at June 30, 2017 | $ 1,087 | $ 523 | $ 692 | $ 69 | $ 69 | $ 273 | $ 7 | $ 2,720 |

Six Months Ended June 30, 2018

| (Dollars in thousands) | Residential 1-4 family | Home Equity | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| Allowance at December 31, 2017 | $ 1,257 | $ 489 | $ 776 | $ 83 | $ 70 | $ 239 | $ 6 | $ 2,920 |
| Provision (credit) | 352 | (28) | 121 | (12) | 2 | 126 | 8 | 569 |
| Loans charged-off | | | | | | (143) | | (143) |

| (Dollars in thousands) | Residential 1-4 family | Home Equity | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| Recoveries | | 3 | | | | 6 | 3 | 12 |
| Allowance at June 30, 2018 | $ 1,609 | $ 464 | $ 897 | $ 71 | $ 72 | $ 228 | $ 17 | $ 3,358 |

Six Months Ended June 30, 2017

| (Dollars in thousands) | Residential 1-4 family | Home Equity | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| Allowance at December 31, 2016 | $ 1,009 | $ 541 | $ 596 | $ 60 | $ 51 | $ 228 | $ 8 | $ 2,493 |
| Provision (credit) | 78 | (20) | 96 | 9 | 18 | 42 | (10) | 213 |
| Loans charged-off | (6) | | | | | | | (6) |
| Recoveries | 6 | 2 | | | | 3 | 9 | 20 |
| Allowance at June 30, 2017 | $ 1,087 | $ 523 | $ 692 | $ 69 | $ 69 | $ 273 | $ 7 | $ 2,720 |

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

The allowance for loan losses and loan balances by impaired and non-impaired components are as follows at the dates indicated:

June 30, 2018

| (Dollars in thousands) | Residential 1-4 family | Home Equity | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| Allowance for impaired loans | $ 5 | $ 6 | $ | $ | $ | $ | $ 13 | $ 24 |
| Allowance for non-impaired loans | 1,604 | 458 | 897 | 71 | 72 | 228 | 4 | 3,334 |
| Total | $ 1,609 | $ 464 | $ 897 | $ 71 | $ 72 | $ 228 | $ 17 | $ 3,358 |
| Impaired loans | $ 4,682 | $ 1,832 | $ 465 | $ | $ | $ 2,025 | $ 119 | $ 9,123 |
| Non-impaired loans | 390,503 | 66,729 | 173,513 | 13,984 | 13,262 | 38,508 | 1,096 | 697,595 |
| Total loans | $ 395,185 | $ 68,561 | $ 173,978 | $ 13,984 | $ 13,262 | $ 40,533 | $ 1,215 | $ 706,718 |

December 31, 2017

| (Dollars in thousands) | Residential 1-4 family | Home Equity | Commercial Real Estate | Commercial Business | Commercial Construction | SBA | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| Allowance for impaired loans | $ 6 | $ 6 | $ | $ | $ | $ 8 | $ 2 | $ 22 |
| Allowance for non-impaired loans | 1,251 | 483 | 776 | 83 | 70 | 231 | 4 | 2,898 |
| Total | $ 1,257 | $ 489 | $ 776 | $ 83 | $ 70 | $ 239 | $ 6 | $ 2,920 |
| Impaired loans | $ 5,125 | $ 1,845 | $ 476 | $ | $ | $ 2,640 | $ 55 | $ 10,141 |
| Non-impaired loans | 306,970 | 69,999 | 155,548 | 17,158 | 13,552 | 38,380 | 1,174 | 602,781 |
| Total loans | $ 312,095 | $ 71,844 | $ 156,024 | $ 17,158 | $ 13,552 | $ 41,020 | $ 1,229 | $ 612,922 |

## (3) Employee Benefits

***Deferred Compensation Supplemental Executive Plan***

The Bank maintains a non-qualified deferred compensation supplemental executive retirement plan ( DCSERP ) with a senior executive. The DCSERP allows the executive to invest all or a portion of the deferred compensation in Corporation Stock, provided that such stock will only be settled in Corporation Stock. The assets invested in bonds, which are held in a Rabbi Trust, related to this Plan totaled $1.4 million at June 30, 2018 and at December 31, 2017, and are included in other assets at fair value in the consolidated balance sheet. The liability for the benefit obligation reported in accrued expenses and other liabilities totaled $1.4 million at June 30, 2018 and at December 31, 2017. Additionally, the Rabbi Trust holds 8,900 shares of Corporation stock at June 30, 2018 and December 31, 2017 which is accounted for at its cost basis of $100,000, which is offset in stockholders equity by the benefit obligation of $100,000. Rabbi trust shares are considered outstanding shares for both basic and diluted EPS.

***Supplemental Retirement Agreements***

The Bank has entered into supplemental retirement agreements ( SERP ) with certain executive officers, which provide for payments upon attaining the retirement age specified in the agreements, generally ages 65-67. The present value of these future payments is accrued over the remaining service or vesting term. Supplemental retirement benefits generally accrue as they are vested; however a termination of employment subsequent to a change in control will result in the vesting of all benefits that would have accrued to the officer s normal retirement date. During the three months ended June 30, 2018 and 2017, SERP expense totaled $211,000 and $241,000, respectively. During the six months ended June 30, 2018 and 2017, SERP expense totaled $422,000 and $482,000, respectively.

***Defined Benefit Pension Plan***

Pension expense totaled $0 and $8,000 for the three months ended June 30, 2018 and 2017, respectively, and $0 and $16,000 for the six months ended June 30, 2018 and 2017, respectively. The Bank expects to contribute $8,000 during the plan year ending December 31, 2018.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Employee Benefits** (continued)

***Employee Stock Ownership Plan***

The Corporation maintains an Employee Stock Ownership Plan ( ESOP ) to provide eligible employees the opportunity to own Corporation stock. This plan is a tax-qualified retirement plan for the benefit of all Corporation employees. Contributions are allocated to eligible participants on the basis of compensation, subject to federal tax limits.

The Corporation granted a loan to the ESOP for the purchase of shares of the Corporation s common stock in January 2014. As of June 30, 2018, the ESOP holds 393,004 shares, or 9% of the common stock outstanding on that date. The loan obtained by the ESOP from the Corporation to purchase common stock is payable annually over 25 years at the prime rate, as published in The Wall Street Journal at the beginning of its calendar year, which was 4.5% at January 1, 2018. The loan is secured by the shares purchased, which are held in a suspense account for allocation among participants as the loan is repaid. Any cash dividends paid on allocated shares will, at the direction of the Corporation, be credited to the participant accounts and invested in the Investment Fund; be distributed to the participants in proportion with the participants stock fund account balance; be distributed to the participants within 90 days of the calendar year in which paid in proportion with the participants stock fund account balance; or be used to make payments on the outstanding debt of the ESOP. Cash dividends paid on unallocated shares will be used to repay the outstanding debt of the ESOP then due. If the amount of dividends exceeds the outstanding debt of the ESOP, then, in the sole discretion of the Corporation, cash dividends may be allocated to active participants on a non-discriminatory basis, or be deemed to be general earnings of the ESOP. Shares used as collateral to secure the loan are released and available for allocation to eligible employees as the principal and interest on the loan is paid.

Shares held by the ESOP include the following:

| | **June 30, 2018** |
|---|---|
| Allocated | 63,349 |
| Distributions | (2,930) |
| Committed to be allocated | 7,918 |
| Unallocated | 324,667 |
| | 393,004 |

The fair value of unallocated shares was approximately $9.0 million at June 30, 2018.

Total expense recognized in connection with the ESOP for the three month periods ended June 30, 2018 and 2017 was $109,000 and $78,000, respectively, and $199,000 and $145,000 for the six months periods ended June 30, 2018 and 2017, respectively.

***Termination Benefits***

During the fourth quarter of 2017, the Corporation offered termination benefits of $253,000 to certain employees who were involuntarily terminated. The expense related to the termination benefits were recorded as a component of salaries and employee benefits expense in accordance with FASB Accounting Standards Codification ASC Topic 420 *Exit or disposal Cost Obligations.* The affected employees are not required to render any additional services to receive termination benefits. The benefits are being paid weekly over varying periods up to 52 weeks. At June 30, 2018, of the $253,000 of termination benefits recorded, $107,000 remains unpaid.

## (4) Other Stock-Based Compensation

On May 21, 2015, the Coastway Bancorp, Inc. stockholders approved the 2015 Equity Incentive Plan ( EIP ). Types of awards permitted by the EIP include stock options, restricted stock awards, restricted stock units, and performance awards. The number of shares available for issuance under the EIP was 692,885 at December 31, 2015. Stock options under the EIP will generally expire ten years after the date of grant. Unless otherwise determined by the Compensation Committee, awards under the EIP (other than Performance Awards) shall be granted with a vesting rate not exceeding twenty percent per year, with the first installment vesting no earlier than one year after the date of grant. Upon an involuntary termination following a change in control, all stock options, restricted stock awards and units will become fully vested and performance awards will be deemed earned.

**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Other Stock-Based Compensation** (continued)

In February 2016, the Compensation Committee of the Board of Directors authorized the grant of 91,225 options at a strike price of $12.41 and 39,045 shares of restricted stock to directors and certain key senior executives. The options and the restricted stock both vest over a five year period. The $12.41 fair value of the restricted stock is based on the closing price of the Company s common stock on the date of the grant. The holders of restricted stock participate fully in rewards of stock ownership of the Company, including voting, and dividend rights when vested. The grant-date fair value of stock options of $2.59 was estimated using the Black-Scholes Option-Pricing Model.

In February 2017, the Compensation Committee of the Board of Directors authorized the grant of 26,155 options at a strike price of $16.40 and 11,228 shares of restricted stock to directors and certain key senior executives. The options and the restricted stock both vest over a five year period. The $16.40 fair value of the restricted stock is based on the closing price of the Company s common stock on the date of the grant. The holders of restricted stock participate fully in rewards of stock ownership of the Company, including voting, and dividend rights when vested. The grant-date fair value of stock options of $4.11 was estimated using the Black-Scholes Option-Pricing Model.

Restricted stock expense for the three month periods ended June 30, 2018 and 2017 was $30,000 and $33,000, respectively and restricted stock expense for the six month periods ended June 30, 2018 and 2017 was $60,000 and $62,000, respectively. At June 30, 2018 and 2017, there was $353,000 and $522,000, respectively, of unrecognized salary and employee benefits cost related to restricted stock. Executive officers forfeited 2,683 shares of restricted stock in February 2017 for tax withholding purposes with a fair value of $44,000. An executive who retired, forfeited 3,016 shares of restricted stock at December 31, 2017, and had 380 vested shares returned for tax withholding purposes, with a fair value of $8,000. Executive officers returned 2,694 shares of vested restricted stock in February 2018 for tax withholding purposes with a fair value of $59,000.

Stock option expense for the three months ended June 30, 2018 and 2017 was $16,000 and $17,000, respectively and stock option expense for the six months period ended June 30, 2018 and 2017 was $31,000 and $31,000, respectively. At June 30, 2018 and 2017, there was $189,000 and $271,000, respectively, of unrecognized salary and employee benefits cost related to stock options.

The following presents the assumptions that were used in determining the grant-date fair value of stock options:

| | 2017 Grant |
|---|---|
| Volatility | 15.04% |
| Forfeiture rate | 00.00 |
| Dividend yield | 00.00 |
| Expected term | 8 years |
| Risk free interest rate | 2.25% |

## (5) Earnings per Common Share

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Unallocated ESOP shares are not deemed outstanding for earnings per share calculations.

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| **(Dollars in thousands)** | **2018** | **2017** | **2018** | **2017** |
| Net income applicable to common stock | $ 1,407 | $ 817 | $ 1,854 | $ 1,379 |
| | | | | |
| Weighted average common shares outstanding | 4,356,957 | 4,345,146 | 4,355,329 | 4,352,733 |
| Less: Average unallocated ESOP shares | (326,651) | (342,489) | (328,614) | (344,452) |
| Weighted average number of common shares outstanding basic | 4,030,306 | 4,002,657 | 4,026,715 | 4,008,281 |
| Dilutive impact of stock options | 49,797 | 15,993 | 44,132 | 12,680 |
| Dilutive impact of restricted stock | 15,928 | 9,710 | 16,454 | 9,180 |
| Weighted average number of common shares outstanding diluted | 4,096,031 | 4,028,360 | 4,087,301 | 4,030,141 |
| | | | | |
| Earnings per share basic | $ 0.35 | $ 0.20 | $ 0.46 | $ 0.34 |
| Earnings per share diluted | $ 0.34 | $ 0.20 | $ 0.45 | $ 0.34 |

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Earnings per Common Share** (continued)

In November 2016, the Corporation authorized a program to repurchase, from time to time and as business conditions warrant, up to 223,331 shares of the Corporation s common stock. The Corporation repurchased no shares under this third stock repurchase program during the six months ended June 30, 2018, with 101,548 shares remaining to be repurchased under this program at June 30, 2018. We do not anticipate any further repurchases during the pending period until the acquisition by HONE is complete.

## (6) Off-Balance Sheet Activities and Mortgage Banking

In the normal course of business, there are outstanding commitments and contingencies which are not reflected in the accompanying consolidated financial statements.

***Loan Commitments***

The Bank is a party to conditional commitments to lend funds in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit which include commercial lines of credit and home equity lines that involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Bank s exposure to credit loss is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

The following financial instruments were outstanding whose contract amounts represent credit risk:

| | June 30, 2018 | December 31, 2017 |
|---|---|---|
| | (In thousands) | |
| Commitments to originate loans for portfolio | $ 30,178 | $ 24,390 |
| Commitments to originate loans to be sold | 32,943 | 13,959 |
| Commitments to purchase loans from third parties | 684 | 8,986 |
| Unfunded commitments under home equity lines of credit | 57,872 | 58,282 |
| Unfunded commitments under commercial lines of credit | 20,358 | 16,478 |
| Unfunded commitments under SBA lines of credit | 4,695 | 4,829 |
| Unfunded commitments under overdraft lines of credit | 193 | 183 |

| | | |
|---|---|---|
| Unadvanced funds on construction loans | 2,926 | 7,426 |

The commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for lines-of-credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based upon management s credit evaluation of the counterparty. Collateral held generally consists of real estate.

***Mortgage Banking***

At June 30, 2018, the Bank had $32.9 million of interest rate lock commitments to borrowers and loans held for sale of $16.2 million with $43.9 million of forward commitments for the future delivery of residential mortgage loans. Included in the forward commitments total are open To Be Announced securities ( TBAs ) with a notional amount of $18.5 million, mandatory delivery contracts with a notional amount of $6.0 million, and best efforts contracts with a notional amount of $19.4 million. The Bank has $6.3 million of closed hedge instruments that are not settled at June 30, 2018.

At December 31, 2017, the Bank had $14.0 million of interest rate lock commitments to borrowers and loans held for sale of $11.1 million with $22.5 million of forward commitments for the future delivery of residential mortgage loans. Included in the forward commitments total are open TBAs with a notional amount of $9.5 million, mandatory delivery contracts with a notional amount of $3.4 million, and best efforts contracts with a notional amount of $9.6 million. The Bank has $5.0 million of closed hedge instruments that are not settled at December 31, 2017.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Off-Balance Sheet Activities and Mortgage Banking** (continued)

***Leases***

In May 2017, the Bank entered into two agreements to lease out 8,650 square feet of the corporate headquarters for 63 months, with two additional renewal options of two years each.  In 2018, the Bank entered into an agreement to lease 3,000 square feet of the corporate headquarters for 60 months, commencing on August 1, 2018, with an option to extend for one additional three year period.  The schedule of minimum rental payments to be received under such leases as of December 31 are as follows (in thousands):

| | | |
|---|---|---|
| 2018 | $ | 211 |
| 2019 | | 251 |
| 2020 | | 251 |
| 2021 | | 251 |
| 2022 | | 251 |
| Thereafter | | 56 |
| | $ | 1,271 |

***Legal and Other Loss Contingencies***

At June 30, 2018 there were no material legal proceedings to which the Corporation is a party or of which any of its property is subject, except as follows.  From time to time, the Corporation is a party to various legal proceedings incident to its business.

On May 22, 2018, Fredda Sharfstein, a purported Corporation stockholder, filed a complaint in the United States District Court for the District of Maryland, captioned *Sharfstein v. Coastway Bancorp, Inc., Mark E. Crevier, Francis X. Flaherty, Debra Paul, William A. White, Dennis M. Murphy, James P. Fiore, Lynda Dickinson, Phillip Kydd, David P. DiSanto, Malcolm G. Chace, Jr. and Angelo P. Lopresti, II (Case No. 1:18-cv-01471-ELH)*, against Corporation and each Corporation director (the   Individual Sharfstein Defendants  ).  The lawsuit alleged that the Corporation and the Individual Sharfstein Defendants  violated the federal securities laws by omitting certain material information from Corporation  s definitive proxy statement for the Corporation special stockholders   meeting to approve the merger that in turn rendered affirmative statements made by the Corporation false and misleading.  The relief sought by the lawsuit included both a preliminary and permanent injunction against the completion of the proposed merger, rescissory damages if the proposed merger is completed, and costs, including attorneys   and experts   fees.  The plaintiff voluntarily withdrew this lawsuit in July 2018.

On May 24, 2018, Paul Parshall, a purported Corporation stockholder, filed a complaint, on behalf of himself and all other Corporation public stockholders, of a putative class action lawsuit in the United States District Court for the District of Rhode Island, captioned *Parshall v.*

*Coastway Bancorp, Inc., Mark E. Crevier, Debra Paul, William A. White, Dennis M. Murphy, James P. Fiore, Lynda Dickinson, Phillip Kydd, David P. DiSanto, Malcolm G. Chace, Jr. and Angelo P. Lopresti, II (Case No. 1:18-cv-00279)*, against the Corporation and the certain Corporation directors noted above (collectively, the Individual Parshall Defendants ). The lawsuit alleged that the Corporation and the Individual Parshall Defendants violated the federal securities laws by omitting certain material information from Corporation s definitive proxy statement for the Corporation special stockholders meeting to approve the merger that in turn rendered affirmative statements made by the Corporation false and misleading. The relief sought by the lawsuit included both a preliminary and permanent injunction against the completion of the proposed merger, rescission and rescissory damages if the proposed merger is completed, and costs, including attorneys and experts fees. The plaintiff voluntarily withdrew this lawsuit in July 2018.

The Corporation has accrued $72,000 in legal fees related to aforementioned legal matters as of June 30, 2018.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Off-Balance Sheet Activities and Derivatives** (continued)

The following table presents the fair values of derivative instruments and forward loan sale commitments in the consolidated balance sheets:

| | Assets | | | Liabilities | | |
|---|---|---|---|---|---|---|
| | Balance Sheet Location | | Fair Value | Balance Sheet Location | | Fair Value |
| | | | (In thousands) | | | |
| June 30, 2018 | | | | | | |
| Derivative loan commitments | | | | | | |
| Commitments hedged with best efforts | Other assets | $ | 219 | N/A | $ | |
| Commitments hedged with TBA | Other assets | | 345 | N/A | | |
| Total derivative commitments | | | 564 | N/A | | |
| Forward loan sale commitments | | | | | | |
| Best efforts contracts hedging: | | | | | | |
| Commitments | N/A | | | Other liabilities | | 36 |
| Loans held for sale | N/A | | | Other liabilities | | 21 |
| Total best efforts contracts | | | | | | 57 |
| Mandatory delivery contracts | N/A | | | Other liabilities | | 4 |
| TBA securities | N/A | | | Other liabilities | | 68 |
| Total forward loans sale commitments | | | | | | 129 |
| Total derivative loan and forward loan sale commitments | | $ | 564 | | $ | 129 |
| December 31, 2017 | | | | | | |
| Derivative loan commitments: | | | | | | |
| Commitments hedged with best efforts | Other assets | $ | 32 | N/A | $ | |
| Commitments hedged with TBA | Other assets | | 179 | N/A | | |
| Total derivative commitments | | | 211 | N/A | | |
| Forward loan sale commitments | | | | | | |
| Best efforts contracts hedging: | | | | | | |
| Commitments | Other assets | | 7 | N/A | | |
| Loans held for sale | Other assets | | 18 | N/A | | |
| Total best efforts contracts | | | 25 | | | |
| Mandatory delivery contracts | Other assets | | 10 | N/A | | |
| TBA securities | N/A | | | Other liabilities | | 20 |
| Total forward loan sale commitments | | | 35 | | | 20 |
| Total derivative loan and forward loan sale commitments | | $ | 246 | | $ | 20 |

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Off-Balance Sheet Activities and Derivatives** (continued)

The following table presents information pertaining to the gains and losses on Bank s derivative loan commitments not designated as hedging instruments and forward loan sale commitments:

| | Location of Gain/(Loss) | Three Months Ended June 30, 2018 | Three Months Ended June 30, 2017 | Six Months Ended June 30, 2018 | Six Months Ended June 30, 2017 |
|---|---|---|---|---|---|
| | | (In thousands) | | (In thousands) | |
| Derivative loan commitments | Net gain on sales of loans and other mortgage banking income | $ 212 | $ (133) | $ 353 | $ (91) |
| Best efforts contracts | Net gain on sales of loans and other mortgage banking income | (63) | (12) | (82) | 63 |
| Mandatory delivery contracts | Net gain on sales of loans and other mortgage banking income | (8) | 12 | (14) | 49 |
| TBA securities | Net gain on sales of loans and other mortgage banking income | (25) | 143 | (48) | 79 |
| | | $ 116 | $ 10 | $ 209 | $ 100 |

## (7) Fair Value Measurements

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of an asset or liability is the price which a seller would receive in an orderly transaction between market participants (an exit price). Assets and liabilities are placed in a fair value hierarchy based on fair value measurements using three levels of inputs: (Level 1) quoted market prices in active markets for identical assets or liabilities; (Level 2) significant other observable inputs, including quoted prices for similar items in active markets, quoted prices for identical or similar items in markets that are not active, inputs such as interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates which provide a reasonable basis for fair value determination or inputs derived principally from observed market data; (Level 3) significant unobservable inputs for situations in which there is little, if any, market activity for the asset or liability. Unobservable inputs must reflect reasonable assumptions that market participants would use in pricing the asset or liability, which are developed on the basis of the best information available under the circumstances.

The Bank has elected the fair value option pursuant to Accounting Standards Codification ( ASC ) 825, Financial Instruments for certain closed mortgage loans intended for sale. ASC 825 allows for the irrevocable option to elect fair value accounting for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis that may otherwise not be required to be measured at fair value under other accounting standards. The Bank elected the fair value option for certain residential real estate mortgage loans held for sale pursuant to forward sale commitments in order to better match changes in fair values for the loans with changes in the fair value of the forward loan sale contracts used to economically hedge them. The aggregate fair value of loans held for sale, the contractual balance of loans held for sale and the gain on loans held for sale totaled $16.2 million, $15.7 million and $526,000 at June 30, 2018. The aggregate fair value of loans held for sale, the contractual balance of loans held for sale and the gain on loans held for sale totaled $11.1 million, $10.8 million and $310,000 at December 31, 2017. The change in fair value of loans held for sale reported as a component of net gains on sale of loans and other mortgage

banking income was $(219,000) and $(240,000) for the three months ended June 30, 2018 and 2017, respectively, and $173,000 and $65,000 for the six months ended June 30, 2018 and 2017, respectively.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Fair Value Measurements** (continued)

The following tables summarize significant assets and liabilities carried at fair value and placement in the fair value hierarchy at the dates specified:

| | | June 30, 2018 | |
|---|---|---|---|
| **(Dollars in thousands)** | **(Level 1)** | **(Level 2)** | **(Level 3)** |
| Assets measured on a recurring basis: | | | |
| Derivative loan commitments hedged with best efforts | $ | $ | $ 219 |
| Derivative loan commitments hedged with TBAs | | | 345 |
| Liabilities measured on a non-recurring basis: | | | |
| Forward loan sale commitments: | | | |
| Best efforts contracts hedging loans held for sale | | | 36 |
| Best efforts contracts hedging commitments | | | 21 |
| Mandatory delivery contracts | | 4 | |
| TBA securities | | 68 | |
| Assets measured on a non-recurring basis: | | | |
| Impaired loans (collateral dependent) | | | 346 |

| | | December 31, 2017 | |
|---|---|---|---|
| **(Dollars in thousands)** | **(Level 1)** | **(Level 2)** | **(Level 3)** |
| Assets measured on a recurring basis: | | | |
| Derivative loan commitments hedged with best efforts | $ | $ | $ 32 |
| Derivative loan commitments hedged with TBAs | | | 179 |
| Forward loan sale commitments: | | | |
| Best efforts contracts hedging loans held for sale | | | 7 |
| Best efforts contracts hedging commitments | | | 18 |
| Mandatory delivery contracts | | 10 | |
| Liabilities measured on a non-recurring basis: | | | |
| Forward loan sale commitments: | | | |
| TBA securities | | 20 | |
| Assets measured on a non-recurring basis: | | | |
| Impaired loans | | | 178 |
| Foreclosed real estate | | | 4,223 |

The Bank did not have cause to transfer any assets between the fair value measurement levels during the three and six months ended June 30, 2018 or the year ended December 31, 2017.

Impaired loan balances in the table above represent those collateral dependent impaired loans where management has estimated the credit loss by comparing the loan s carrying value against the expected realizable fair value of the collateral (appraised value or internal analysis less estimated cost to sell, adjusted as necessary for changes in relevant valuation factors subsequent to the measurement date). Certain inputs used in these assessments, and possible subsequent adjustments, are not always observable, and therefore, collateral dependent impaired loans are categorized as Level 3 within the fair value hierarchy. A specific allowance or partial charge-off is recorded to the collateral dependent impaired loan for the amount of management s estimated credit loss. The carrying value of impaired loans recorded at fair value was $346,000, which is net of $15,000 charge-offs and no specific reserves at June 30, 2018. Losses related to collateral dependent impaired loans at fair value during the three and six months ended June 30, 2018 totaled $5,000 and $15,000 respectively. There were no impaired loans recorded at fair value at June 30, 2017.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Fair Value Measurements** (continued)

The carrying value of impaired loans recorded at fair value was $178,000 net of no charge-offs and $3,000 in specific reserves at December 31, 2017 resulted in a provision of $16,000 for the year ended December 31, 2017.

Real estate acquired by the Bank through foreclosure proceedings or the acceptance of a deed in lieu of foreclosure is classified as foreclosed real estate. When property is acquired, it is generally recorded at the estimated fair value of the property acquired, less estimated costs to sell. The estimated fair value is based on market appraisals and the Bank s internal analysis. Certain inputs used in appraisals or the Bank s internal analysis, are not always observable, and therefore, foreclosed real estate may be categorized as Level 3 within the fair value hierarchy. There was no foreclosed real estate carried at fair value at June 30, 2018 and 2017. On February 20, 2018, the Bank entered into a Purchase & Sale Agreement to sell foreclosed real estate with a carrying value of $4.2 million for $4.4 million. There were no and $27,000 in losses in the three and six months ended June 30, 2018 on foreclosed real estate held at December 31, 2017 based on the net proceeds from sale. There were no losses on foreclosed real estate for the three and six months ended June 30, 2017.

***Derivatives fair value methodology***

Fair value changes in mortgage banking derivatives (interest rate lock commitments and commitments to sell fixed-rate residential mortgages) subsequent to inception are estimated using anticipated market prices based on pricing indications provided from syndicate banks and consideration of pull-through and fallout rates. The fair value of the mortgage banking derivatives are considered to be Level 3 assets.

The table below presents for the three and six months ended June 30, 2018 and 2017, the change in Level 3 assets and liabilities that are measured on a recurring basis:

| | Derivative Loan Commitments and Forward Loan Sale Commitments Three months ended June 30, | | | |
|---|---|---|---|---|
| **(Dollars in thousands)** | | **2018** | | **2017** |
| Balance at beginning of period | $ | 358 | $ | 635 |
| Gains on new commitments during the period | | 507 | | 501 |
| Gain (losses) arising during the period | | (2) | | (17) |
| Reclassifications of realized gains (losses) on settled commitments | | (356) | | (629) |
| Balance at end of period | $ | 507 | $ | 490 |

| (Dollars in thousands) | Derivative Loan Commitments and Forward Loan Sale Commitments Six months ended June 30, 2018 | 2017 |
|---|---|---|
| Balance at beginning of period | $ 236 | $ 518 |
| Gains on new commitments during the period | 507 | 490 |
| Gain (losses) arising during the period | | (12) |
| Reclassifications of realized gains (losses) on settled commitments | (236) | (506) |
| Balance at end of period | $ 507 | $ 490 |

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Fair Value Measurements** (continued)

The following tables present additional quantitative information about assets and liabilities measured at fair value on a recurring and non-recurring basis for which the Bank utilized Level 3 inputs (significant unobservable inputs for situations in which there is little, if any, market activity for the asset or liability) to determine fair value:

June 30, 2018

| (Dollars in thousands) | Fair Value | Valuation Technique | Unobservable Input | Unobservable Input Value or Range |
|---|---|---|---|---|
| Assets measured on a recurring basis: | | | | |
| Derivative loan commitments | $ 564 | Investor pricing | Pull-through rate | 74.8% - 100% |
| Liabilities measured on a recurring basis: | | | | |
| Best efforts contracts hedging commitments: | 36 | Investor pricing | Pull-through rate | 82.5% - 100% |
| Best efforts contracts hedging loans held for sale | 21 | Investor pricing | Pull-through rate | 82.5% - 100% |
| Assets measured on a non-recurring basis: | | | | |
| Impaired loans (collateral dependent) | 346 | Discounted appraisals | Collateral discounts | 5 30% |

December 31, 2017

| (Dollars in thousands) | Fair Value | Valuation Technique | Unobservable Input | Unobservable Input Value or Range |
|---|---|---|---|---|
| Assets measured on a recurring basis: | | | | |
| Derivative commitments | $ 211 | Investor pricing | Pull-through rate | 74.2% - 100% |
| Forward loan sale commitments: | | | | |
| Best efforts contracts hedging commitments | 7 | Investor pricing | Pull-through rate | 82.5% - 100% |
| Best efforts contracts hedging loans held for sale | 18 | Investor pricing | Pull-through rate | 82.5% - 100% |
| Assets measured on a non-recurring basis: | | | | |
| Impaired loans (collateral dependent) | 178 | Discounted appraisals | Collateral discounts | 5 30% |
| Foreclosed real estate | 4,223 | Discounted appraisals | Collateral discounts | 10 43% |

*Estimated Fair Values of Assets and Liabilities*

In addition to disclosures regarding the measurement of assets and liabilities carried at fair value on the balance sheet, the Corporation is also required to disclose fair value information about financial instruments for which it is practicable to estimate that value, whether or not recognized on the balance sheet. In cases where quoted fair values are not available, fair values are based upon estimates using various valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The following methods and assumptions were used by the Corporation in estimating fair values of its financial instruments.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Fair Value Measurements** (continued)

The following methods and assumptions were used by the Corporation in estimating fair value disclosures:

Cash and cash equivalents The carrying amounts of cash and cash equivalents approximate fair values based on the short-term nature of the assets.

Federal Home Loan Bank stock It is not practical to determine the fair value of Federal Home Loan Bank stock due to restrictions placed on its transferability.

Loans, net For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Loans held for sale Fair values of loans held for sale are based on prevailing market rates for loans with similar characteristics.

Accrued interest receivable The carrying amounts of accrued interest receivable approximates fair value.

Deposits The fair values of deposits with no stated maturity, such as demand deposits, savings, club and money market accounts, are equal to the amount payable on demand at the reporting date. Fair values for term certificates are estimated using a discounted cash flow calculation that applies market interest rates currently being offered for deposits of similar remaining maturities.

Borrowed funds  The fair values of the Bank s FHLB advances are estimated using discounted cash flow analyses based on the current incremental borrowing rates in the market for similar types of borrowing arrangements.

Accrued interest payable  The carrying amounts of accrued interest payable approximate fair value.

The estimates of fair value of financial instruments were based on information available at June 30, 2018 and December 31, 2017 and are not indicative of the fair market value of those instruments as of the date of this report. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Corporation s entire holdings of a particular financial instrument. The fair value of the Corporation s deposit liabilities do not take into consideration the value of the Corporation s long-term relationships with depositors, which may have significant value.

Because no active market exists for a portion of the Corporation s financial instruments, fair value estimates were based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates were based on existing financial instruments without an attempt to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments, including premises and equipment and foreclosed real estate.

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**COASTWAY BANCORP, INC. AND SUBSIDIARY**

Notes to the Unaudited Consolidated Financial Statements (continued)

**Fair Value Measurements** (continued)

The carrying values, estimated fair values and placement in the fair value hierarchy of the Corporation s financial instruments for which fair value is only disclosed but not recognized on the balance sheet at the dates indicated are summarized as follows:

| | June 30, 2018 (unaudited) | | Fair value measurement | | |
|---|---|---|---|---|---|
| **(Dollars in thousands)** | **Carrying Amount** | **Fair Value** | **Level 1 inputs** | **Level 2 Inputs** | **Level 3 Inputs** |
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 50,084 | $ 50,084 | $ 50,084 | $ | $ |
| Loans, net | 708,755 | 699,940 | | | 699,940 |
| Loans held for sale | 16,238 | 16,238 | | 16,238 | |
| FHLB stock | 11,368 | N/A | N/A | N/A | N/A |
| Accrued interest receivable | 2,267 | 2,267 | | | 2,267 |
| Financial liabilities: | | | | | |
| Non-certificate accounts | 338,898 | 338,898 | 338,898 | | |
| Certificate accounts | 163,046 | 162,568 | | 162,568 | |
| Borrowed funds | 250,950 | 250,765 | | 250,765 | |
| Accounts interest payable | 81 | 81 | | 81 | |

| | December 31, 2017 | | Fair value measurement | | |
|---|---|---|---|---|---|
| **(Dollars in thousands)** | **Carrying Amount** | **Fair Value** | **Level 1 inputs** | **Level 2 Inputs** | **Level 3 Inputs** |
| Financial assets: | | | | | |
| Cash and cash equivalents | $ 54,569 | $ 54,569 | $ 54,569 | $ | $ |
| Loans, net | 614,593 | 616,649 | | | 616,649 |
| Loans held for sale | 11,077 | 11,077 | | 11,077 | |
| FHLB stock | 8,299 | N/A | N/A | N/A | N/A |
| Accrued interest receivable | 1,962 | 1,962 | | | 1,962 |
| Financial liabilities: | | | | | |
| Non-certificate accounts | 313,636 | 313,636 | 313,636 | | |
| Certificate accounts | 163,320 | 163,252 | | 163,252 | |
| Borrowed funds | 181,675 | 181,494 | | 181,494 | |
| Accrued interest payable | 118 | 118 | | 118 | |

## Item 2 - Management s Discussion and Analysis of Financial Condition and Results of Operations

Management s discussion and analysis should be read in conjunction with the Corporation s (also referred to herein as, Company s us, we or o consolidated financial statements and notes thereto contained in this report and the Corporation s 2017 audited consolidated financial statements.

**Special Note Regarding Forward-Looking Statements**

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements concerning plans, objectives, future events or performance and assumptions and other statements that are other than statements of historical fact. Forward-looking statements may be identified by reference to a future period or periods or by use of forward-looking terminology such as anticipates, believes, expects, intends, may, plans, pursue, views and similar terms or expressions. Various sta contained in Item 2 - Management s Discussion and

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Analysis of Financial Condition and Results of Operations including, but not limited to, statements related to management s views on the banking environment and the economy, competition and market expansion opportunities, the interest rate environment, credit risk and the level of future non-performing assets and charge-offs, potential asset and deposit growth, future non-interest expenditures and non-interest income growth, and borrowing capacity are forward-looking statements. The Corporation wishes to caution readers that such forward-looking statements reflect numerous assumptions and involve a number of risks and uncertainties that may adversely affect the Corporation s future results. The following important factors, among others, could cause the Corporation s results for subsequent periods to differ materially from those expressed in any forward-looking statement made herein: (i) changes in interest rates could negatively impact net interest income; (ii) changes in the business cycle and downturns in the local, regional or national economies, including deterioration in the local real estate market, could negatively impact credit and/or asset quality and result in credit losses and increases in the Corporation s allowance for loan losses and/or valuations of foreclosed properties; (iii) changes in consumer spending could negatively impact the Corporation s credit quality and financial results; (iv) increasing competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services could adversely affect the Corporation s competitive position within its market area and reduce demand for the Corporation s products and services; (v) in connection with the acquisition by HONE: failure of the parties to satisfy the conditions to complete the merger in a timely manner or at all; failure to obtain governmental approvals or the imposition of adverse regulatory conditions in connection with such approvals; and the merger may be more expensive to complete than anticipated, including as a result of unexpected factors or events, (vi) deterioration of securities markets could adversely affect the value or credit quality of the Corporation s assets and the availability of funding sources necessary to meet the Corporation s liquidity needs; (vii) changes in technology could adversely impact the Corporation s operations and increase technology-related expenditures; (viii) increases in employee compensation and benefit expenses and other non-interest expenses could adversely affect the Corporation s financial results; (ix) changes in laws and regulations that apply to the Corporation s business and operations, including without limitation, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ), the Jumpstart Our Business Startups Act (the JOBS Act ) and the additional regulations that will be forthcoming as a result thereof, could adversely affect the Corporation s business environment, operations and financial results; (x) changes in accounting standards, policies and practices, as may be adopted or established by the regulatory agencies, the Financial Accounting Standards Board (the FASB ) or the Public Company Accounting Oversight Board ( PCAOB ) could negatively impact the Corporation s financial results; (xi) our ability to enter new markets successfully and capitalize on growth opportunities; (xii) future regulatory compliance costs, including any increase caused by new regulations imposed by the Consumer Finance Protection Bureau; and (xiii) some or all of the risks and uncertainties described in Risk Factors of the Corporation s annual report on Form 10-K or in the quarterly reports on Form 10-Q could be realized, which could have a material adverse effect on the Corporation s business, financial condition and results of operation. Therefore, the Corporation cautions readers not to place undue reliance on any such forward-looking information and statements.

**Accounting Policies/Critical Accounting Estimates**

As discussed in the 2017 audited consolidated financial statements included in the Corporation s annual report on Form 10-K, the most significant areas in which management applies critical assumptions and estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, the valuation of deferred tax assets, and the valuation of loans held for sale, mortgage banking derivatives and commitments to sell fixed rate residential mortgages. The Corporation has not changed its significant accounting and reporting policies from those disclosed in its 2017 audited consolidated financial statements.

**Overview**

Coastway Bancorp, Inc. is a Maryland corporation and owns 100% of the common stock of Coastway Community Bank. On January 14, 2014, we completed our initial public offering ( IPO ) of common stock in connection with the mutual-to-stock conversion of Coastway Bancorp, MHC, selling 4,827,125 shares of common stock at $10.00 per share (contributing $300,000 in cash and 122,054 shares of common stock to Coastway Cares Charitable Foundation II) and raising $48.3 million of gross proceeds. In June 2018, Rhode Island Passive Investment Corp. was formed which is a wholly-owned subsidiary of the Bank.

On March 14, 2018, the Company and HONE announced they had entered into a definitive agreement under which HONE will acquire the Company in an all cash transaction valued at approximately $125.6 million.  The Company s stockholders will receive $28.25 for each share of Company common stock that they own.  The transaction is expected to close in the second half of 2018 and is subject to customary closing conditions, including the approval of the Company s stockholders and required regulatory approvals.  On June 21, 2018, the Company s stockholders approved the merger. However, it is possible that factors outside the control of both companies, including whether or when the required regulatory approvals will be received, could result in the merger being delayed or not completed at all.

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The Corporation s earnings are largely dependent on net interest income which is the difference between interest earned on loans, investments and cash and cash equivalents, and the cost of funding (primarily deposits and borrowed funds). The re-pricing frequency of the Corporation s assets and liabilities are not identical, and therefore subject the Corporation to the risk of adverse changes in interest rates. Due to the growth in the fixed-rate one- to four-family residential loan portfolio, coupled with the increase in short-term borrowed funds, our interest-bearing liabilities may re-price more quickly than our interest-earning assets in an increasing interest rate environment. The Corporation s earnings are also dependent on the net gains on sales of loans, and other mortgage banking income, which is volatile. When interest rates rise, the demand for mortgage loans tends to fall and may reduce the number of loans we can originate for sale. Weak or deteriorating economic conditions also tend to reduce loan demand. The Corporation s operating expenses are high as a percentage of net interest income and non-interest income, due to prior branch growth and increase in personnel as we positioned the Bank for future growth.

***General.*** Net income was $1.4 million for the three months ended June 30, 2018 as compared to net income of $817,000 for the three months ended June 30, 2017, an increase of $590,000. The increase in earnings for the three months ended June 30, 2018 as compared to the same period in 2017 was primarily due to an increase in net interest income of $919,000 as well as an increase of $53,000 in total non-interest income primarily due to increased customer service fees. The increase in net interest income of $919,000 was primarily due to an increase of $1.7 million in loan interest income, partially offset by an increase of $872,000 in interest expense on borrowed funds. Net income for the three months ended June 30, 2018 as compared to the same period in 2017 was unfavorably impacted by an increase in non-interest expense of $246,000, as a result of $278,000 in merger expenses included in professional fees. Excluding the impact of $278,000 in merger expenses, non-interest expense would have decreased $32,000 for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. On March 14, 2018, the Corporation and HONE announced they had entered into a definitive agreement under which HONE will acquire the Corporation in an all cash transaction valued at approximately $125.6 million. On June 21, 2018, the Corporation s stockholders approved the merger. Net income was also unfavorably impacted by an increase of $54,000 in the provision for loan losses primarily due to net loan growth, coupled with additional credit risk associated with increased interest rates.

Net income increased $475,000 to $1.9 million for the six months ended June 30, 2018 as compared to net income of $1.4 million for the six months ended June 30, 2017, primarily due to an increase in net interest income from $9.5 million for the six months ended June 30, 2017 to $11.1 million for the six months ended June 30, 2018. The increase in net interest income was due to an increase in loan interest income of $2.9 million primarily due to loan growth, partially offset by an increase in interest expense of $1.6 million, primarily due to a $1.4 million increase in interest expense on borrowed funds to fund loan growth. The earnings results for the six months ended June 30, 2018 was also impacted by an increase to the provision for loan losses of $356,000 due to net loan growth, to a provision and related charge-off of an $125,000 nonperforming SBA loan, and additional credit risk associated with increased interest rates. Total non-interest income decreased $151,000, primarily due to a decrease of $208,000 in net gains on sales of loans and other mortgage banking income. Other income declined $81,000 from $108,000 to $27,000 primarily due to a decrease in the value of assets held for the benefit of an executive s non-qualified deferred compensation supplemental executive retirement plan during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. The aforementioned decreases in non-interest income were partially offset by an increase in customer service fees of $147,000 to $1.8 million for the six months ended June 30, 2018 from $1.7 million for the six months ended June 30, 2017 primarily due to higher VISA, ATM and NSF fees. Non-interest expenses increased $616,000, or 5.7%, to $11.3 million for the six months ended June 30, 2018 from $10.7 million for the six months ended June 30, 2017. The increase in non-interest expenses was primarily due to an increase in professional fees of $695,000, of which $676,000 was related to merger related legal and other professional fees in connection with the pending acquisition of the Company by HONE. Excluding the impact of the merger related expenses of $676,000, non-interest expense decreased $60,000 for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

**Comparison of Financial Condition at June 30, 2018 and December 31, 2017**

***Assets.*** Our total assets increased $96.0 million, or 13.0%, to $834.9 million at June 30, 2018 from $738.9 million at December 31, 2017 primarily due to an increase in loans held for investment. Total loans increased $93.8 million, or 15.3%, to $706.7 million at June 30, 2018 from $612.9 million at December 31, 2017. The increase in total loans was primarily due to an increase in residential one- to four-family loans of $83.1 million, or 26.6%, to $395.2 million at June 30, 2018 from $312.1 million at December 31, 2017. Residential one-to four-family loans increased due to purchases of $64.5 million of loans at a purchase price of $65.3 million from third parties as well as organic loan growth. Commercial real estate loans increased $18.0 million, or 11.5% to $174.0 million at June 30, 2018 as compared to $156.0 million at December 31, 2017. Cash and cash equivalents decreased $4.5 million during the six months ended June 30, 2018 primarily due to a decrease in interest-earning deposits. Loans held for sale increased $5.2 million during the six months ended June 30, 2018 as loan originations outpaced loan sales.

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***Loans.*** A summary of the balances of loans are as follows:

| | June 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| **(Dollars in thousands)** | | **Amount** | **Percent** | | **Amount** | **Percent** |
| Residential real estate: | | | | | | |
| 1-4 family | $ | 395,185 | 55.92% | $ | 312,095 | 50.92% |
| Home equity loans and lines of credit | | 68,561 | 9.70 | | 71,844 | 11.72 |
| Commercial real estate | | 173,978 | 24.62 | | 156,024 | 25.46 |
| Commercial business | | 13,984 | 1.98 | | 17,158 | 2.80 |
| Commercial construction | | 13,262 | 1.88 | | 13,552 | 2.21 |
| SBA loans | | 40,533 | 5.73 | | 41,020 | 6.69 |
| Consumer | | 1,215 | 0.17 | | 1,229 | 0.20 |
| Total loans | | 706,718 | 100.00% | | 612,922 | 100.00% |
| Net deferred loan costs | | 5,395 | | | 4,591 | |
| Allowance for loan losses | | (3,358) | | | (2,920) | |
| Total loans, net | $ | 708,755 | | $ | 614,593 | |

***Deposits.*** Our primary source of funds is retail deposits held by individuals and businesses within our market area. Deposits increased $25.0 million, or 5.2%, to $501.9 million at June 30, 2018 from $477.0 million at December 31, 2017. Non-interest bearing demand deposits increased $17.0 million from $116.9 million at December 31, 2017 to $133.9 million at June 30, 2018, based in part upon timing of month end. The increase in deposits was also a result of an increase of $7.8 million or 7.1%, in savings and interest bearing deposit accounts.

The following table sets forth the deposit balances by certain categories at the dates indicated and the percentage of each category to total deposits.

| | June 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| **(Dollars in thousands)** | | **Amount** | **Percent** | | **Amount** | **Percent** |
| Non-interest bearing demand deposits | $ | 133,913 | 26.68% | $ | 116,888 | 24.51% |
| Money market accounts | | 85,809 | 17.10 | | 85,575 | 17.94 |
| Savings and interest-bearing demand deposit accounts | | 117,423 | 23.39 | | 109,664 | 22.99 |
| Club accounts | | 1,753 | 0.35 | | 1,509 | 0.32 |
| Total transaction accounts | | 338,898 | 67.52 | | 313,636 | 65.76 |
| Certificates of deposit | | 163,046 | 32.48 | | 163,320 | 34.24 |
| Total deposits | $ | 501,944 | 100.00% | $ | 476,956 | 100.00% |

***Borrowed Funds***. We utilize borrowings from the Federal Home Loan Bank of Boston ( FHLBB ) as an alternate funding source. Borrowed funds at June 30, 2018 totaled $251.0 million as compared to $181.7 million at December 31, 2017, an increase of $69.3 million, or 38.1%. Borrowed funds at June 30, 2018 were comprised of $249.2 million of short-term advances at a weighted average rate of 2.08% as compared to short-term advances of $179.9 million at December 31, 2017 at a weighted average rate of 1.49%. The increase in short term advances during the six months ended June 30, 2018 was to fund the increase in loans. Long-term FHLBB advances totaled $1.8 million at June 30,

2018 and December 31, 2017, were borrowed at no cost under the FHLBB s Jobs for New England Program, and mature in 2021.

***Total Stockholders Equity***. Total stockholders equity increased to $73.4 million at June 30, 2018 from $71.3 million at December 31, 2017. The increase in stockholders equity was primarily due to net income of $1.9 million and $199,000 of ESOP shares committed to be allocated.

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***Nonperforming Assets***

Loans on which the accrual of interest has been discontinued are designated as non-performing loans. Accrual of interest on loans is generally discontinued when contractual payments of principal or interest have become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is performing. When a loan is placed on non-accrual status, unpaid interest credited to income is reversed. Interest received on nonaccrual loans is applied against principal or interest or is recognized in income on a cash basis, until qualifying for return to accrual. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current, the loan has performed in accordance with the contractual terms for a reasonable period of time, typically a minimum of six months, and future payments are reasonably assured.

Loans are classified as troubled debt restructured loans when certain modifications are made to the loan terms and concessions are granted to the borrowers due to financial difficulty experienced by those borrowers. The modifications of the terms of such loans were one of the following: a reduction of the stated interest rate of the loan for some period of time, an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk, or an extension of time to make payments with the delinquent payment added to the principal of the loan. Loans on nonaccrual status at the date of modification are initially classified as non-accruing troubled debt restructurings. Troubled debt restructured loans may be returned to accrual status after a period of satisfactory and reasonable future payment performance under the terms of the restructuring. Satisfactory payment performance is generally six months of current payments.

Non-performing loans decreased to $4.3 million, or 0.60% of total loans at June 30, 2018, from $4.7 million, or 0.77% of total loans, at December 31, 2017 primarily due to a $419,000 decrease in non-performing one- to four-family residential loans. A restructured residential one- to four-family loan with a balance of $420,000 was moved to performing status in 2018 due to satisfactory payment performance, and a $107,000 one- to four-family loan paid off. The decreases in residential non-performing loans was partially offset by the addition of a $150,000 residential loan to non-performing status, for which the collateral appears to be sufficient to cover the exposure. SBA non-performing troubled debt restructured loans decreased $125,000 during the six months ended June 30, 2018 primarily due to a partial charge-off on a past due loan.

Non-performing assets are comprised of non-performing loans, and foreclosed real estate. The designation of a loan or other asset as non-performing does not necessarily indicate that loan principal and interest will ultimately be uncollectible. However, management recognizes the greater risk characteristics of these assets and therefore considers the potential risk of loss on assets included in this category in evaluating the adequacy of the allowance for loan losses. Despite prudent loan underwriting, adverse changes within the Bank s market area, or deterioration in local, regional or national economic conditions, could negatively impact the Bank s level of non-performing loans and assets in the future.

Foreclosed real estate consists of property acquired through formal foreclosure or the acceptance of a deed in lieu of foreclosure, and is recorded at fair value less costs to sell. There was no foreclosed real estate at June 30, 2018 and $4.2 million at December 31, 2017, which was comprised of real estate securing a former commercial loan. On February 20, 2018, the Bank entered into a Purchase & Sale Agreement to sell the foreclosed real estate for $4.4 million. The sale closed during the second quarter of 2018.

***Accruing Troubled Debt Restructured Loans***

Accruing troubled debt restructurings totaled $4.9 million at June 30, 2018, a decrease of $550,000 from $5.4 million at December 31, 2017. The decrease in accruing troubled debt restructurings was primarily due to two home equity loans totaling $118,000 becoming troubled debt restructured loans which were transferred to non-accruing status based on the borrowers declaring bankruptcy, though the loans remain current, as well as one borrower who paid off two SBA loans totaling $191,000, and made a principal reduction on a third SBA loan of $182,000.

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The table below sets forth the amounts and categories of our nonperforming assets at the dates indicated. For the dates presented, there were no loans delinquent 90 days or more and still accruing.

| **(Dollars in thousands)** | **June 30, 2018** | **December 31, 2017** |
|---|---|---|
| Nonaccrual loans: | | |
| Residential real estate mortgage loans: | | |
| 1-4 family | $ 1,444 | $ 1,571 |
| Home equity loans and lines of credit | 105 | 86 |
| Commercial real estate loans | | |
| Commercial business loans | | |
| SBA loans | 222 | 274 |
| Commercial construction loans | | |
| Consumer loans | | |
| Total nonaccrual loans | 1,771 | 1,931 |
| Non-accruing troubled debt restructured loans: | | |
| Residential real estate mortgage loans: | | |
| 1-4 family | 1,522 | 1,814 |
| Home equity loans and lines of credit | 596 | 487 |
| Commercial real estate loans | 254 | 254 |
| Commercial business loans | | |
| SBA loans | 125 | 250 |
| Commercial construction loans | | |
| Consumer loans | | |
| Total non-accruing troubled debt restructured loans | 2,497 | 2,805 |
| Total nonperforming loans | 4,268 | 4,736 |
| Foreclosed real estate: | | |
| Residential real estate mortgage loans: | | |
| 1-4 family | | |
| Home equity loans and lines of credit | | |
| Commercial real estate loans | | 4,223 |
| Commercial business loans | | |
| SBA loans | | |
| Commercial construction loans | | |
| Consumer loans | | |
| Total foreclosed real estate | | 4,223 |
| Total nonperforming assets | $ 4,268 | $ 8,959 |
| | | |
| Total accruing troubled debt restructured loans | $ 4,855 | $ 5,405 |
| Delinquent loans 60 89 days past due | $ 237 | $ 924 |
| Ratios: | | |
| Loans 60-89 days past due to total loans | 0.03% | 0.15% |
| Non-performing loans to total loans | 0.60% | 0.77% |
| Non-performing assets to total assets | 0.51% | 1.21% |

For the three months ended June 30, 2018 and 2017, gross interest income which would have been recorded had the non-performing loans been current in accordance with their original terms amounted to $60,000 and $36,000, respectively. The

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amount that was included in interest income on such loans totaled $44,000 and $43,000 for the three months ended June 30, 2018 and 2017, respectively. For the six months ended June 30, 2018 and 2017, gross interest income which would have been recorded had the non-performing loans been current in accordance with their original terms amounted to $122,000 and $88,000, respectively. The amount that was included in interest income on such loans totaled $102,000 and $92,000 for the six months ended June 30, 2018 and 2017, respectively.

***Asset Quality***

Federal regulations provide for the classification of loans and other assets, such as debt and equity securities considered by the FDIC to be of lesser quality, as substandard , doubtful , or loss . An asset is substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of 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 corrected. Assets classified as doubtful have all of the weaknesses present to 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 reserve 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.

In accordance with our loan policy, we regularly review the problem loans in our portfolio to determine whether any loans require classification in accordance with applicable regulations. Loans are listed on the watch list initially because of emerging financial weaknesses even though the loan is currently performing as agreed, or if the loan possesses weaknesses although currently performing. If a loan deteriorates in asset quality the classification is changed to special mention , substandard doubtful or loss depending on the circumstances and the evaluation. Based on this review, we had classified or held as special mention the following loans as of the date indicated:

| (Dollars in thousands) | June 30, 2018 | December 31, 2017 |
|---|---|---|
| Special mention | $ 47 | $ 76 |
| Substandard | 4,467 | 5,632 |
| Doubtful | 125 | |
| Loss | | |
| Total classified and special mention loans | $ 4,639 | $ 5,708 |

The level of classified and special mention loans decreased by $1.1 million to $4.6 million at June 30, 2018 from $5.7 million at December 31, 2017. Substandard loans decreased $1.2 million during the six months ended June 30, 2018, primarily as a result of $128,000 in partial charge-offs on three SBA loans as a result of an assessment of collectability and their past due status, and principal repayments, and the payoff or paydown of three loans to one SBA relationship of $373,000, and the related upgrade to pass of the one remaining loan to this borrower of $349,000.

***Allowance for Loan Losses***

The allowance for loan losses is the amount necessary to reflect probable incurred losses in the portfolio. The Corporation evaluates the adequacy of the allowance for loan losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings.

The Corporation s methodology for assessing the appropriateness of the allowance for loan losses consists of two key elements: (1) specific allowances for identified impaired loans; and (2) a general valuation allowance on the remainder of the portfolio. Although the Corporation determines the amount of each element of the allowance separately, the entire allowance is available for the entire portfolio.

The Corporation identifies loans that may need to be charged off by reviewing delinquent loans, classified loans, and other loans about which management may have concerns about collectability. For individually reviewed loans, the borrower s inability to make payments under the terms of the loan as well as the shortfall in collateral value could result in a charge-off of the loan or the portion of the loan that was impaired.

Among other factors, the Corporation considers current general economic conditions, including current housing price depreciation, in determining the appropriateness of the allowance for loan losses for the Corporation s residential real estate portfolio. The Corporation uses evidence obtained from its own loan portfolio, including loss history, as well as published

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housing data in its local markets from third party sources believed to be reliable as a basis for assumptions about the impact of housing depreciation.

Substantially all of the Corporation s loans are secured by collateral. Loans 90 days past due or on non-accrual as well as TDRs are evaluated for impairment and specific allowances are established. Typically for a non-performing impaired real estate loan, the value of the underlying collateral is estimated using an independent appraisal, adjusted for property specific conditions and other factors, and related specific reserves are adjusted on a quarterly basis. If a non-performing impaired real estate loan is in the process of foreclosure, and/or there are serious doubts about further collectability of principal or interest, and there is uncertainty about the value of the underlying collateral, a new appraisal may be ordered. Any shortfall would result in immediately charging off the portion of the loan that was impaired.

The Corporation evaluates the need for 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 less estimated selling expenses.

The general component of the allowance for loan losses is established for loans that are not classified as impaired to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, has not been allocated to particular problem assets. This general valuation allowance is determined by segregating the loans by loan category (segments) and assigning allowance percentages based on a ten year historical loss period to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; charge-off trends over the past three year period; weighted average risk ratings; loan concentrations; management s assessment of internal factors; and management s assessment of external factors such as interest rates, real estate markets and local and national economic factors. Although the allowance for loan losses is allocated to various portfolio categories, it is general in nature and available for the loan portfolio in its entirety. The allowance may be adjusted for significant factors that in management s judgment, affect the collectability of the portfolio as of the evaluation date. The applied loss factors are reevaluated quarterly to ensure their relevance in the current and overall economic environment and in relation to trends in the loan portfolio.

Despite prudent loan underwriting, adverse changes within the Corporation s market area, or further deterioration in the local, regional or national economic conditions including a decline in real estate market values in Rhode Island, an increase in interest rates, as well as bank regulatory examination and/or independent loan review results could negatively impact the Corporation s level of allowance for loan losses and non-performing assets in the future.

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The following table summarizes the activity in the allowance for loan losses for the periods indicated:

| (Dollars in thousands) | Three months ended June 30, 2018 | Three months ended June 30, 2017 | Six months ended June 30, 2018 | Six months ended June 30, 2017 |
|---|---|---|---|---|
| Balance at beginning of period | $ 3,162 | $ 2,559 | $ 2,920 | $ 2,493 |
| Provision for loan losses | 207 | 153 | 569 | 213 |
| Charge-offs: | | | | |
| Residential 1-4 family | | (6) | | (6) |
| Home equity loans and lines of credit | | | | |
| Commercial real estate loans | | | | |
| Commercial business loans | | | | |
| SBA | (15) | | (143) | |
| Commercial construction | | | | |
| Consumer | | | | |
| Total charge-offs | (15) | (6) | (143) | (6) |
| Recoveries on charged-off loans | | | | |
| Residential 1-4 family | | 6 | | 6 |
| Home equity loans and lines of credit | 1 | 1 | 3 | 2 |
| Commercial real estate loans | | | | |
| Commercial business loans | | | | |
| SBA | 1 | | 6 | 3 |
| Commercial construction | | | | |
| Consumer | 2 | 7 | 3 | 9 |
| Total recoveries | 4 | 14 | 12 | 20 |
| Net (charge-offs) recoveries | (11) | 8 | (131) | 14 |
| Balance at end of period | $ 3,358 | $ 2,720 | $ 3,358 | $ 2,720 |
| Annualized net loans (charge-offs) recoveries to average loans outstanding | (0.01)% | 0.01% | (0.04)% | 0.02% |
| Allowance for loan losses to non-performing loans at end of period | 78.68% | 78.03% | 78.68% | 78.03% |
| Allowance for loan losses to total loans at end of period | 0.48% | 0.48% | 0.48% | 0.48% |

The allowance reflects management s estimate of loan loss reserves necessary to support the level of credit risk inherent in the portfolio during the periods. Refer to the Corporation s annual report on Form 10-K for additional information regarding the Corporation s credit risk management process and allowance for loan losses.

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**Comparison of Operating Results for the Three Months Ended June 30, 2018 and June 30, 2017.**

***General.*** Net income was $1.4 million for the three months ended June 30, 2018 as compared to net income of $817,000 for the three months ended June 30, 2017, an increase of $590,000. The increase in earnings for the three months ended June 30, 2018 as compared to the same period in 2017 was primarily due to an increase in net interest income of $919,000 as well as an increase of $53,000 in total non-interest income primarily due to increased customer service fees. The increase in net interest income of $919,000 was primarily due to an increase of $1.7 million in loan interest income, partially offset by an increase of $872,000 in interest expense on borrowed funds. Net income for the three months ended June 30, 2018 as compared to the same period in 2017 was unfavorably impacted by an increase in non-interest expense of $246,000, as a result of $278,000 in merger expenses included in professional fees. Excluding the impact of $278,000 in merger expenses, non-interest expense would have decreased $32,000 for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. On March 14, 2018, the Corporation and HONE announced they had entered into a definitive agreement under which HONE will acquire the Corporation in an all cash transaction valued at approximately $125.6 million. On June 21, 2018, the Corporation s stockholders approved the merger. Net income was also unfavorably impacted by an increase of $54,000 in the provision for loan losses primarily due to net loan growth, coupled with additional credit risk associated with increased interest rates.

***Interest Income.*** Interest income increased $1.8 million, or 32.0%, to $7.7 million for the three months ended June 30, 2018 from $5.9 million for the three months ended June 30, 2017. The increase reflected an increase in the average balance of interest-earning assets of $157.7 million to $760.5 million for the three months ended June 30, 2018 as compared to $602.8 million for the three months ended June 30, 2017, and an increase in the average yield on interest-earning assets to 4.08% for the three months ended June 30, 2018 as compared to 3.90% for the three months ended June 30, 2017. The majority of our interest income was derived from interest and fees on loans. The average yield on interest-earning assets increased by 18 basis points to 4.08% primarily due to the 12 basis points increase in the average loan yield and the $146.4 million increase in average loans and loans held for sale during the three months ended June 30, 2018 as compared to the same prior year period.

Interest and fees on loans increased $1.7 million, or 30.1%, to $7.4 million for the three months ended June 30, 2018 from $5.7 million for the three months ended June 30, 2017. Interest and fees on loans increased due to an increase in the average balance of loans and loans held for sale of $146.4 million to $703.6 million for the three months ended June 30, 2018 as compared to $557.2 million for the three months ended June 30, 2017. The increase in our average balance of loans was principally due to the growth in our residential one-to four- family real estate loan portfolio. Our average yield on loans increased to 4.23% for the three months ended June 30, 2018 from 4.11% for the three months ended June 30, 2017 primarily due to an increase in market interest rates.

Interest income on cash and cash equivalents increased $93,000 to $184,000 for the three months ended June 30, 2018 from $91,000 for the three months ended June 30, 2017 due primarily to the 69 basis points increase in the average yield as a result of the increase in the Fed Funds rate, coupled with a $6.2 million increase in average cash and cash equivalents as we increased our on-balance sheet liquidity in light of loan growth.

***Interest Expense.*** Interest expense increased $953,000, or 93.2%, to $2.0 million for the three months ended June 30, 2018 from $1.0 million for the three months ended June 30, 2017 primarily due to a $872,000 increase in interest expense on borrowed funds, coupled with an increase of $81,000 in interest expense on deposits. Interest expense on certificates of deposit increased $28,000 due primarily to an increase of 10 basis points in the average cost of certificates of deposit as compared to the same prior year period primarily due to certificates of deposit specials implemented to remain competitive as interest rates have increased. Interest expense on money market accounts increased $52,000 due primarily to an increase in the average cost of funds which increased to 0.61% for the three months ended June 30, 2018 from 0.42% for the three months ended June 30, 2017 as the Bank implemented a money market special rate promotion at 1.25% in the fourth quarter of 2017. The average balance of money market accounts increased $12.7 million to $85.5 million for the three months ended June 30, 2018 as compared to the prior year period.

Interest expense on borrowed funds increased $872,000 to $1.2 million for the three months ended June 30, 2018 from $290,000 for the three months ended June 30, 2017 due to a 94 basis points increase in the average cost of funds to 1.97% for the three months ended June 30, 2018 as short-term interest rates increased in March 2017, June 2017, December 2017, March 2018 and June 2018. The average balance of borrowed funds increased $124.2 million to $236.9 million for the three months ended June 30, 2018 from $112.7 million for the three months ended June 30, 2017 as we increased our FHLBB advances to fund loan growth.

***Net Interest Income.*** Net interest income increased $919,000, or 19.0%, to $5.8 million for the three months ended June 30, 2018 from $4.8 million for the three months ended June 30, 2017. This increase was due to a $16.3 million increase in net interest-earning assets to $157.0 million for the three months ended June 30, 2018, partially offset by a decrease in our interest rate spread of 25 basis points to 2.76% for the three months ended June 30, 2018 as compared to 3.01% for the prior

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year period. The net interest margin decreased 18 basis points to 3.04% for the three months ended June 30, 2018 from 3.22% for the three months ended June 30, 2017.

*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 for the periods indicated. 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.

| | | Three months ended June 30, 2018 vs. 2017 | |
|---|---|---|---|
| **(Dollars in thousands)** | **Net change** | **Volume** | **Rate** |
| Interest earning assets: | | | |
| Loans and loans held for sale | $ 1,720 | $ 1,551 | 169 |
| Cash and cash equivalents | 93 | 11 | 82 |
| Federal Home Loan Bank of Boston stock and other investments | 59 | 57 | 2 |
| Total interest-earning assets | 1,872 | 1,619 | 253 |
| Interest-bearing liabilities: | | | |
| Money market accounts | $ 52 | 8 | 44 |
| Savings accounts | 1 | 2 | (1) |
| Club accounts | | | |
| Certificates of deposit | 28 | (12) | 40 |
| Borrowed funds | 872 | 478 | 394 |
| Total interest-bearing liabilities | 953 | 476 | 477 |
| Net interest income | $ 919 | $ 1,143 | $ (224) |

The following table sets forth average balance sheets, average yields and costs, and certain other information for the three months ended June 30, 2018 and 2017. No tax-equivalent yield adjustments were made, as we had no non-taxable interest-earning assets during the periods presented. All average balances are daily average balances. Nonaccrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred loan fees, discounts and premiums that are amortized or accreted to interest income or interest expense.

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**AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS**

| | Three months ended June 30, 2018 | | | Three months ended June 30, 2017 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Average Balance | Interest | Average Yield(4) | Average Balance | Interest | Average Yield(4) |
| Assets: | | | | | | |
| Loans and loans held for sale | $ 703,607 | $ 7,426 | 4.23% | $ 557,211 | $ 5,706 | 4.11% |
| Cash and cash equivalents | 46,104 | 184 | 1.60 | 39,897 | 91 | 0.91 |
| Federal Home Loan Bank of Boston stock and other investments | 10,754 | 121 | 4.51 | 5,671 | 62 | 4.39 |
| Total interest-earning assets | 760,465 | 7,731 | 4.08 | 602,779 | 5,859 | 3.90 |
| Non-interest-earning assets | 42,160 | | | 40,965 | | |
| Total assets | $ 802,625 | | | $ 643,744 | | |
| Liabilities and Equity: | | | | | | |
| Money market accounts | $ 85,470 | 129 | 0.61 | $ 72,740 | 77 | 0.42 |
| Savings accounts | 116,114 | 28 | 0.10 | 108,794 | 27 | 0.10 |
| Club accounts | 1,736 | | | 1,494 | | |
| Certificates of deposit | 163,151 | 657 | 1.62 | 166,244 | 629 | 1.52 |
| Total interest-bearing deposits | 366,471 | 814 | 0.89 | 349,272 | 733 | 0.84 |
| Borrowed funds | 236,946 | 1,162 | 1.97 | 112,745 | 290 | 1.03 |
| Total interest bearing liabilities | 603,417 | 1,976 | 1.31 | 462,017 | 1,023 | 0.89 |
| Non-interest bearing deposits | 118,640 | | | 105,742 | | |
| Other liabilities | 8,479 | | | 7,093 | | |
| Total liabilities | 730,536 | | | 574,852 | | |
| Stockholders equity | 72,089 | | | 68,892 | | |
| Total liabilities and stockholders equity | $ 802,625 | | | $ 643,744 | | |
| Net interest income | | $ 5,755 | | | $ 4,836 | |
| Net interest rate spread(1) | | | 2.76% | | | 3.01% |
| Net interest-earning assets(2) | $ 157,048 | | | $ 140,762 | | |
| Net interest margin(3) | | | 3.04% | | | 3.22% |
| Average interest-earning assets to interest-bearing liabilities | | | 126.03% | | | 130.47% |

(1) Net interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average rate of interest-bearing liabilities.

(2) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(3) Net interest margin represents net interest income divided by average total interest-earning assets.

(4) Annualized.

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***Provision for loan losses*****.** A provision for loan losses of $207,000 was recorded to the allowance for loan losses during the three months ended June 30, 2018, an increase of $54,000 as compared to a provision of $153,000 for the three months ended June 30, 2017. During the three months ended June 30, 2018, a provision of $193,000 was recorded relating to the residential one-to four- family loan portfolio primarily due to loan growth and a provision of $52,000 was recorded relating to the commercial real estate loan portfolio primarily due to loan growth coupled with additional credit risk associated with increased interest rates. We recorded credit provisions of $14,000, $10,000, $10,000 and $13,000 for the three months ended June 30, 2018 relating to the home equity, commercial, construction and SBA portfolios primarily due to decreases in loan balances. We recorded net charge-offs of $11,000 for the three months ended June 30, 2018. Our provisions are based on our assessment of loss history, current asset quality and economic trends.

A provision for loan losses of $153,000 was recorded to the allowance for loan losses during the three months ended June 30, 2017. During the three months ended June 30, 2017, a provision of $54,000 was recorded to the residential one- to four-family loan portfolio due to loan growth, a provision of $63,000 was recorded to the commercial real estate loan portfolio primarily due to loan growth coupled with additional credit risk associated with the increase in interest rates, and a $42,000 provision was recorded related to the SBA portfolio primarily due to increased general reserves on loans risk rated special mention.

***Non-Interest income*****.** Non-interest income increased $53,000, or 2.7%, to $2.0 million for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. The $53,000 increase was primarily due to an increase of $82,000 in customer service fees primarily due to an increase in VISA, ATM and NSF fees. Net gains on sales of loans and other mortgage banking income and other income decreased $14,000 for the three months ended June 30, 2018 as compared to the same period in 2017. Gains on sales of mortgage loans decreased $435,000 to $678,000 for the three months ended June 30, 2018 from $1.1 million for the three months ended June 30, 2017, due to a decrease in the net margin and a decrease in the volume of mortgage loans sold as compared to the prior year period. Mortgage loans sold during the three months ended June 30, 2018 totaled $41.9 million as compared to $50.0 million during the three months ended June 30, 2017. A gain in the fair value of mortgage derivatives and net change in the fair value of loans held for sale of $319,000 was recorded during the three months ended June 30, 2018 as compared to a loss of $111,000 during the three months ended June 30, 2017.

***Non-Interest expenses*****.** Non-interest expense increased $246,000, or 4.7%, to $5.5 million for the three months ended June 30, 2018 from $5.3 million for the three months ended June 30, 2017. The $246,000 increase in non-interest expenses was primarily due to an increase in professional fees of $300,000, of which $278,000 was the result of merger related legal and other professional fees in connection with the pending acquisition of the Company by HONE. Excluding the impact of the merger related expenses of $278,000, non-interest expenses decreased $32,000 for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. FDIC insurance increased $49,000 for the three months ended June 30, 2018 to $122,000 from $73,000 for the three months ended June 30, 2017 primarily due to asset growth.

Partially offsetting the increases in non-interest expenses was a decrease in salary and employee benefits expense of $91,000 and a decrease of $44,000 in occupancy and equipment expense for the three months ended June 30, 2018 as compared to the same period in 2017. The $91,000

decrease in salary and employee benefits expense for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017 was primarily due to a decrease of four full time equivalents to 147, a decrease of $21,000 related to an executive s non-qualified deferred compensation supplemental executive retirement plan due to a decrease in value of plan assets, and a $30,000 decrease in SERP expense, partially offset by general merit increases, and a $31,000 increase in ESOP expense due to the increase in value of Company stock for the three months ended June 30, 2018 as compared to the same period in 2017. The decrease in occupancy and equipment expense of $44,000 was primarily due to $41,000 in rental income from the leases of our first floor of our corporate headquarters (lease did not exist during second quarter of 2017).

***Income tax expense***. Income tax expense of $638,000 was recorded for the three months ended June 30, 2018, an increase of $82,000, or 14.7%, as compared to $556,000 of income tax expense for the three months ended June 30, 2017. The increase in income tax expense was primarily due to an increase in pre-tax income of $672,000 during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. The effective tax rates for the three months ended June 30, 2018 and 2017 were 31.2% and 40.5%, respectively. The decrease in the effective tax rate was due to the income tax impact related to the enactment of the Tax Act which reduced the corporate federal tax statutory rate from 34% to 21%, and the income tax benefit recorded relating to the vesting of restricted stock, partially offset by the impact of non-deductible merger expenses.

**Comparison of Operating Results for the Six Months Ended June 30, 2018 and June 30, 2017**

***General.*** Net income increased $475,000 to $1.9 million for the six months ended June 30, 2018 as compared to net income of $1.4 million for the six months ended June 30, 2017, primarily due to an increase in net interest income from $9.5 million for the six months ended June 30, 2017 to $11.1 million for the six months ended June 30, 2018. The increase in net

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interest income was due to an increase in loan interest income of $2.9 million primarily due to loan growth, partially offset by an increase in interest expense of $1.6 million, primarily due to a $1.4 million increase in interest expense on borrowed funds to fund loan growth. The earnings results for the six months ended June 30, 2018 was also impacted by an increase to the provision for loan losses of $356,000 due to net loan growth, a provision and related charge-off of an $125,000 nonperforming SBA loan, and additional credit risk associated with increased interest rates. Total non-interest income decreased $151,000, primarily due to a decrease of $208,000 in net gains on sales of loans and other mortgage banking income. Other income declined $81,000 from $108,000 to $27,000 primarily due to a decrease in the value of assets held for the benefit of an executive s non-qualified deferred compensation supplemental executive retirement plan during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. The aforementioned decreases in non-interest income were partially offset by an increase in customer service fees of $147,000 to $1.8 million for the six months ended June 30, 2018 from $1.7 million for the six months ended June 30, 2017 primarily due to higher VISA, ATM and NSF fees. Non-interest expenses increased $616,000, or 5.7%, to $11.3 million for the six months ended June 30, 2018 from $10.7 million for the six months ended June 30, 2017. The increase in non-interest expenses was primarily due to an increase in professional fees of $695,000, of which $676,000 was related to merger related legal and other professional fees in connection with the pending acquisition of the Company by HONE. Excluding the impact of the merger related expenses of $676,000, non-interest expense decreased $60,000 for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

***Interest Income.*** Interest income increased $3.2 million, or 27.8%, to $14.7 million for the six months ended June 30, 2018 from $11.5 million for the six months ended June 30, 2017. The increase reflected an increase in the average balance of interest-earning assets of $131.7 million to $729.4 million for the six months ended June 30, 2018 as compared to $597.8 million for the six months ended June 30, 2017. The average yield on interest-earning assets increased to 4.05% for the six months ended June 30, 2018 as compared to 3.87% for the six months ended June 30, 2017. The majority of our interest income was derived from interest and fees on loans.

Interest and fees on loans increased $2.9 million, or 26.4%, to $14.1 million for the six months ended June 30, 2018 from $11.2 million for the six months ended June 30, 2017. Interest and fees on loans increased due to an increase in the average balance of loans and loans held for sale of $124.0 million to $675.0 million for the six months ended June 30, 2018 as compared to $551.0 million for the six months ended June 30, 2017. The increase in our average balance of loans was principally due to the growth in our residential one-to four- family loan portfolio during the six months ended June 30, 2018. Our average yield on loans increased to 4.22% for the six months ended June 30, 2018 as compared to 4.09% for the six months ended June 30, 2017 primarily due to an increase in market interest rates.

Interest income on cash and cash equivalents increased $164,000 to $328,000 for the six months ended June 30, 2018 from $164,000 for the six months ended June 30, 2017 primarily due to the 67 basis points increase in the average yield which increased to 1.48% from 0.81% due to the increase in Fed Funds rate.

***Interest Expense.*** Interest expense increased $1.6 million, or 81.9%, to $3.6 million for the six months ended June 30, 2018 from $2.0 million for the six months ended June 30, 2017 primarily due to an increase of $1.4 million in interest expense on borrowed funds.

Interest expense on deposits increased $182,000 from $1.4 million for the six months ended June 30, 2017 to $1.6 million for the six months ended June 30, 2018. Interest expense on money market accounts increased $99,000 to $251,000 for the six months ended June 30, 2018, from $152,000 for the six months ended June 30, 2017 primarily due to a 17 basis points increase in the cost of funds to 0.59% from 0.42% due to the implementation of a money market special. Interest expense increased $80,000 on certificates of deposit primarily due to an increase of 11 basis points in the average cost of funds to 1.62%, due to certificates of deposit specials implemented to remain competitive as interest rates have

increased.

Interest expense on borrowed funds increased $1.4 million to $1.9 million for the six months ended June 30, 2018 from $516,000 for the six months ended June 30, 2017 primarily due to an increase in the average cost of borrowed funds. The average cost of borrowed funds increased 91 basis points to 1.82% for the six months ended June 30, 2018 from 0.91% for the six months ended June 30, 2017, due to the increase in short-term interest rates. The average balance of borrowed funds increased $101.3 million to $215.1 million for the six months ended June 30, 2018 from the six months ended June 30, 2017, as we increased short-term average borrowings to fund loan growth.

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***Net Interest Income.*** Net interest income increased $1.6 million, or 16.7%, to $11.1 million for the six months ended June 30, 2018 from $9.5 million for the six months ended June 30, 2017. This increase was due to an $11.6 million increase in net interest-earning assets to $150.6 million for the six months ended June 30, 2018 as compared to the prior year period. This increase was partially offset by a decrease in our interest rate spread of 20 basis points to 2.81% for the six months ended June 30, 2018 as compared to 3.01% for the prior year period. The net interest margin decreased to 3.07% for the six months ended June 30, 2018 from 3.21% for the six months ended June 30, 2017.

*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 for the periods indicated. 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.

| | Six months ended June 30, 2018 vs. 2017 Increase (decrease) due to | | |
|---|---|---|---|
| **(Dollars in thousands)** | **Net Change** | **Volume** | **Rate** |
| Interest-earning assets: | | | |
| Loans and loans held for sale | $ 2,945 | 2,606 | $ 339 |
| Cash and cash equivalents | 164 | 13 | 151 |
| Federal Home Loan Bank of Boston stock and other investments | 83 | 90 | (7) |
| Total interest-earning assets | 3,192 | 2,709 | 483 |
| Interest-bearing liabilities: | | | |
| Money Market accounts | 99 | 18 | 81 |
| Savings accounts | 3 | 3 | |
| Club accounts | | | |
| Certificates of deposit | 80 | (13) | 93 |
| Borrowed funds | 1,420 | 674 | 746 |
| Total interest-bearing liabilities | 1,602 | 682 | 920 |
| | | | |
| Net interest income | $ 1,590 | $ 2,027 | $ (437) |

The following table sets forth average balance sheets, average yields and costs, and certain other information for the six months ended June 30, 2018 and 2017. No tax-equivalent yield adjustments were made, as we had no non-taxable interest-earning assets during the periods presented. 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 loan fees, discounts and premiums that are amortized or accreted to interest income or interest expense.

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**AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS**

| (Dollars in thousands) | Six months ended June 30, 2018 Average Balance | Interest | Average Yield(4) | Six months ended June 30, 2017 Average Balance | Interest | Average Yield(4) |
|---|---|---|---|---|---|---|
| Assets: | | | | | | |
| Loans and loans held for sale | $ 675,045 | $ 14,114 | 4.22% | $ 551,004 | $ 11,169 | 4.09% |
| Cash and cash equivalents | 44,598 | 328 | 1.48 | 40,929 | 164 | 0.81 |
| Federal Home Loan Bank of Boston stock and other investments | 9,801 | 222 | 4.57 | 5,822 | 139 | 4.81 |
| Total interest-earning assets | 729,444 | 14,664 | 4.05 | 597,755 | 11,472 | 3.87 |
| Non-interest-earning assets | 43,736 | | | 40,936 | | |
| Total assets | $ 773,180 | | | $ 638,691 | | |
| Liabilities and Equity: | | | | | | |
| Money market accounts | $ 85,567 | 251 | 0.59 | $ 72,315 | 152 | 0.42 |
| Savings accounts | 113,088 | 55 | 0.10 | 106,014 | 52 | 0.10 |
| Club accounts | 1,627 | 1 | 0.12 | 1,424 | 1 | 0.14 |
| Certificates of deposit | 163,486 | 1,314 | 1.62 | 165,208 | 1,234 | 1.51 |
| Total interest-bearing deposits | 363,768 | 1,621 | 0.90 | 344,961 | 1,439 | 0.84 |
| Borrowed funds | 215,073 | 1,936 | 1.82 | 113,811 | 516 | 0.91 |
| Total interest bearing liabilities | 578,841 | 3,557 | 1.24 | 458,772 | 1,955 | 0.86 |
| Non-interest bearing deposits | 114,416 | | | 104,245 | | |
| Other liabilities | 8,217 | | | 6,954 | | |
| Total liabilities | 701,474 | | | 569,971 | | |
| Stockholders equity | 71,706 | | | 68,720 | | |
| Total liabilities and stockholders equity | $ 773,180 | | | $ 638,691 | | |
| Net interest income | | $ 11,107 | | | $ 9,517 | |
| Net interest rate spread(1) | | | 2.81% | | | 3.01% |
| Net interest-earning assets(2) | $ 150,603 | | | $ 138,983 | | |
| Net interest margin(3) | | | 3.07% | | | 3.21% |
| Average interest-earning assets to interest-bearing liabilities | | | 126.02% | | | 130.29% |

(1) Net interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest- bearing liabilities.

(2) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

(3) Net interest margin represents net interest income divided by average total interest-earning assets.

(4) Annualized.

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*Provision for loan losses*. A provision of $569,000 was recorded during the six months ended June 30, 2018. We recorded $352,000 of the provision for the six months ended June 30, 2018 related to the residential one- to four-family loan portfolio primarily due to loan growth and $121,000 of the provision related to the commercial real estate loan portfolio based on loan growth as well as the additional credit risk associated with increased interest rates. We recorded a provision of $126,000 for the six months ended June 30, 2018 related to the SBA portfolio primarily due to a provision and related charge-off of an $125,000 nonperforming SBA loan. We recorded a credit provision of $28,000 for the six months ended June 30, 2018 related to the home equity portfolio primarily due to a decrease in the book value of the portfolio. We recorded net charge-offs of $131,000 for the six months ended June 30, 2018.

A provision of $213,000 was recorded during the six months ended June 30, 2017. We recorded $78,000 of the provision for the six months ended June 30, 2017 related to the residential one- to four-family loan portfolio primarily due to loan growth and $96,000 of the provision related to the commercial real estate loan portfolio based on loan growth as well as the additional credit risk associated with increased interest rates. We recorded a provision of $42,000 for the six months ended June 30, 2017 related to the SBA portfolio primarily due to increased general reserves on loans risk rated special mention and substandard. We recorded a credit provision of $20,000 for the six months ended June 30, 2017 related to the home equity portfolio primarily due to a decrease in the book value of the portfolio. We recorded net recoveries of $14,000 for the six months ended June 30, 2017.

*Non-Interest income*. Non-interest income decreased $151,000, or 4.1%, to $3.6 million for the six months ended June 30, 2018 from $3.7 million for the six months ended June 30, 2017. The decrease in non-interest income was primarily due to a decrease of $208,000 in net gains on sales of loans and other mortgage banking income. Gains on sales of mortgage loans decreased $884,000 from $2.0 million for the six months ended June 30, 2017 to $1.1 million for the six months ended June 30, 2018. The decrease in the net gain on sales of mortgage loans was due to a decrease in the net margin on the sales of mortgage loans during the first six months of 2018 coupled with the lower volume of loans sold. Mortgage loans sold during the six months ended June 30, 2018 amounted to $80.8 million as compared to $107.2 million during the six months ended June 30, 2017. A gain resulting from the increase in the fair value of mortgage derivatives, commitments to sell and loans held for sale of $519,000 was recorded during the six months ended June 30, 2018 as compared to a loss of $190,000 for the six months ended June 30, 2017, resulting in an increase of $709,000 between periods. Other income declined $81,000 from $108,000 for the six months ended June 30, 2017 to $27,000 for the six months ended June 30, 2018 primarily due to a decrease in the value of assets held for the benefit of an executive s non-qualified deferred compensation supplemental executive retirement plan during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. Customer service fees increased $147,000 to $1.8 million for the six months ended June 30, 2018 from $1.7 million for the six months ended June 30, 2017 primarily due to higher VISA, ATM and NSF fees.

*Non-Interest expenses*. Non-interest expenses increased $616,000, or 5.7%, to $11.3 million for the six months ended June 30, 2018 from $10.7 million for the six months ended June 30, 2017. The increase in non-interest expenses was primarily due to an increase in professional fees of $695,000, of which $676,000 was the result of merger related legal and other professional fees in connection with the pending acquisition of the Company by HONE. Excluding the impact of the merger related expenses of $676,000, non-interest expense decreased $60,000 for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. FDIC insurance increased $80,000 for the six months ended June 30, 2018 to $232,000 from $152,000 for the six months ended June 30, 2017 primarily due to asset growth.

Partially offsetting the increases in non-interest expenses, salary and employee benefits expense decreased $151,000 for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017 primarily due to a decrease of four full time equivalents to 147 at June 30, 2018 from 151 at June 30, 2017, a decrease of $90,000 related to an executive s non-qualified deferred compensation supplemental executive retirement plan due to a decrease in value of plan assets, and a $61,000 decrease in SERP expense, partially offset by general merit increases, and a $55,000 increase in ESOP expense due to the increase in value of Company stock for the six months ended June 30, 2018 as compared to the same period in 2017. Occupancy expense decreased $90,000 to $1.6 million for the six months ended June 30, 2018 from $1.7 million for the six months ended June 30, 2107 primarily due to rental income from the leases of our first floor of our corporate headquarters. Other general and administrative expenses increased $54,000 to $977,000 for the six months ended June 30, 2018 as compared to $923,000 for the comparable 2017 period primarily due to increased education and training expenses as well as postage expense.

***Income tax expense.*** Income tax expense of $910,000 was recorded for the six months ended June 30, 2018, a decrease of $8,000, as compared to $918,000 of income tax expense for the six months ended June 30, 2017. The decrease in the effective tax rate was due to the income tax impact related to the enactment of the Tax Act which reduced the corporate federal tax statutory rate from 34% to 21%, and the income tax benefit recorded relating to the vesting of restricted stock, partially offset by the impact of non-deductible merger expenses and the impact of the increase in compensation expense of ESOP shares committed to be allocated due to the increase in market value of our stock during the six months ended June 30,

2018 as compared to the six months ended June 30, 2017. The effective tax rate for the six months ended June 30, 2018 was 32.9% as compared to 40.0% for the six months ended June 30, 2017.

**Liquidity**

Liquidity is the ability to meet current and future financial obligations. Our primary sources of funds consist of deposit inflows, loans repayments, advances from the Federal Home Loan Bank of Boston, principal repayments and loans sales. While maturities and scheduled amortization of loans are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. Our Asset/Liability Committee, under the direction of the Chief Financial Officer, is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. We believe that we have enough sources of liquidity coupled with our pending acquisition by HONE to satisfy our short- and long-term liquidity needs as of June 30, 2018.

The Corporation regularly monitors and adjusts its investments in liquid assets based upon an assessment of:

(i) Expected loan demand including commitments to purchase loans;

(ii) Expected deposit flows and borrowing maturities;

(iii) Yields available on interest-earning deposits; and

(iv) The objectives of our asset/liability management program.

Excess liquid assets are invested generally in interest-earning deposits and are also used to pay off short-term borrowings.

The Corporation s most liquid assets are cash and cash equivalents. The level of these assets is dependent on operating, financing, lending and investing activities during any given period. At June 30, 2018, cash and cash equivalents totaled $50.1 million.

The Corporation s cash flows are derived from operating activities, investing activities and financing activities as reported in the Consolidated Statements of Cash Flows included in the Consolidated Financial Statements.

At June 30, 2018, the Bank had $63.1 million in commitments to originate loans, $32.9 million of which will be sold. In addition to commitments to originate loans, the Bank had $83.1 million in unused lines of credit to borrowers as of the same date. Commitments to purchase loans from third parties totaled $684,000 at June 30, 2018. Certificates of deposit due within one year of June 30, 2018 totaled $62.0 million, or 12.2%, of total deposits, of which $25.0 million are national market certificates of deposit. If these deposits do not remain with us,

we may be required to seek other sources of funds, including utilizing additional Federal Home Loan Bank of Boston advances and selling the guaranteed portions of SBA loans of $20.7 million as of June 30, 2018. Depending on market conditions, the Bank may be required to pay higher rates on such deposits or other borrowed funds than it currently pays on the certificates of deposit due on or before June 30, 2019. Management believes, however, based on historical experience and current market interest rates, that the Bank will retain upon maturity, a large portion of certificates of deposit with maturities of one year or less as of June 30, 2018.

The Corporation s primary investing activity is originating loans. During the six months ended June 30, 2018 and for the year ended December 31, 2017, loan originations, net of principal repayments totaled $30.0 million, and $50.4 million, respectively. During the six months ended June 30, 2018 and the year ended December 31, 2017, purchases of loans from third party originators totaled $65.3 million and $44.4 million, respectively.

Financing activities consist primarily of activity in deposit accounts, borrowed funds from the Federal Home Loan Bank of Boston advances and stock repurchases. We experienced a net increase in deposits of $25.0 million and $29.6 million for the six months ended June 30, 2018 and for the year ended December 31, 2017, respectively. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors. The net increase in short term borrowed funds was $69.3 million during the six months ended June 30, 2018 as compared to an increase of $60.4 million for the year ended December 31, 2017.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of Boston that provide an additional source of funds. Borrowed funds were $251.0 million and $181.7 million at June 30, 2018 and December 31, 2017, respectively, all with the FHLBB. At June 30, 2018, we had the ability to borrow up to an additional $52.8 million from the Federal Home Loan Bank of Boston. We also have the ability to borrow with the Federal Reserve discount window. At

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June 30, 2018, the Bank had the capacity to borrow up to $18.0 million from the Federal Reserve discount window, but had no outstanding borrowings as of that date.

**Capital Resources**

The Corporation believes its current capital is adequate to support ongoing operations. In July 2013, the Bank s primary federal regulator, the FDIC, published final rules (the Basel III Capital Rules ) that implement, in part, agreements reached by the Basel Committee on Banking Supervision ( Basel Committee ) in Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems ( Basel III ) and imposed new capital requirements on the Bank, effective January 1, 2015. When fully phased in, the Basel III Capital Rules will additionally require institutions to retain a capital conservation buffer, composed of CET1, of 2.5% above these required minimum capital ratio levels. Banking organizations that fail to maintain the minimum 2.5% capital conservation buffer could face restrictions on capital distributions or discretionary bonus payments to executive officers. Restrictions would begin phasing in where the banking organization s capital conservation buffer was below 2.5% at the beginning of a quarter, and distributions and discretionary bonus payments would be completely prohibited if no capital conservation buffer exists. When the capital conservation buffer is fully phased in on January 1, 2019, the Bank will effectively have the following minimum capital to risk-weighted assets ratios: a) 7.0% based upon CET1; b) 8.5% based upon tier 1 capital; and c) 10.5% based upon total regulatory capital. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and increases by 0.625% each subsequent January 1, until it reaches 2.5% on January 1, 2019. For 2018, the capital conservation buffer is 1.875%. As of June 30, 2018, the Bank qualifies as well capitalized under applicable regulations of the Rhode Island Department of Business Regulation and the FDIC. To be categorized as well capitalized under Basel III, framework, the Bank must maintain minimum Total Capital, Tier 1 and Common Equity Tier 1 Capital ratios of 10%, 8% and 6.5% respectively, and, maintain a leverage capital ratio (Tier 1 capital to average assets) of at least 5%. Not withstanding the foregoing, The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 (the Regulatory Relief Act ) simplifies capital calculations by requiring bank regulators to establish for institutions under $10 billion in assets a community bank leverage ratio (tangible equity to average consolidated assets) at a percentage not less than 8% and not greater than 10% that such institutions may elect to replace the general applicable risk-based capital requirements under the Basel III capital rules. Such institutions that meet the community bank leverage ratio will automatically be deemed to be well-capitalized, although the bank regulators retain the flexibility to determine that the institution may not qualify for the community bank leverage ratio test based on the institution s risk profile. Until the community bank leverage ratio is established by bank regulators in accordance with the Regulatory Relief Act, the Basel III risk-based and leverage ratios remain in effect. The effective date and the specific community bank leverage ratio is unknown.

During the six months ended June 30, 2018, the Corporation made a $3.0 million capital contribution to the Bank to support loan growth.

The Bank s actual capital amounts and ratios are presented as of June 30, 2018 in the table below.

| | Actual | | Minimum Capital for Capital Adequacy Purposes | | Minimum Capital for Adequacy with Capital Buffer | | Minimum Capital To Be Well Capitalized | |
|---|---|---|---|---|---|---|---|---|
| **(Dollars in thousands)** | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| Total Capital (to risk weighted assets) | $ 69,775 | 12.899% | $ 43,275 | 8.00% | $ 53,417 | 9.875% | $ 54,094 | 10.00% |
| Tier 1 Capital (to risk weighted assets) | 66,417 | 12.278 | 32,456 | 6.00 | 42,599 | 7.875 | 43,275 | 8.00 |
| Common Equity Tier 1 (to risk weighted assets) | 66,417 | 12.278 | 24,342 | 4.50 | 34,485 | 6.375 | 35,161 | 6.50 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Tier 1 Leverage Capital (to average assets) | 66,417 | 8.278 | 32,094 | 4.00 | N/A | N/A | 40,117 | 5.00 |

On April 9, 2015, the Board of Governors of the Federal Reserve System issued the Final Rule to implement Public Law 113-250 enacted on December 18, 2014 that updates the Small Bank Holding Company Policy Statement ( Policy Statement ), which became effective in May 2015. Pursuant to the Policy Statement, capital rules and reporting requirements will not apply to the small bank holding companies (defined as less than $1.0 billion in assets and will be increased to $3 billion by the Regulatory Relief Act) which meet the following criteria: (1) not engaged in significant non-bank activities; (2) no significant off-balance sheet activities conducted through a non-bank subsidiary, and (3) no material amount of SEC registered debt or equity securities outstanding (other than trust preferred). The Bank is subject to the capital rules and reporting requirements though the Holding Company is exempt.

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## Item 3 - Quantitative and Qualitative Disclosures About Market Risk

**Management of Market Risk**

Our asset/liability management strategy attempts to manage the impact of changes in interest rates on net interest income, our primary source of earnings. Among the techniques we use or have used to manage interest rate risk are:

- Originating commercial real estate, SBA and commercial business loans, which tend to have shorter terms and higher interest rates than one- to four-family residential real estate loans, and which generate customer relationships that can result in larger non-interest-bearing accounts;

- Retaining originated and purchasing from third party originators, jumbo one- to four-family residential real estate loans, which may carry higher interest rates and may have shorter weighted average lives;

- Selling the majority or our long-term, conforming fixed-rate one- to four-family residential real estate loans that we originate and retaining the majority of the shorter-term adjustable-rate residential real estate loans that we originate;

- Lengthening the weighted average maturity of our liabilities through retail deposit pricing strategies and monitoring the cost of FHLBB advances relative to the cost of retail deposits; and

- Monitoring core deposit levels and pricing to allow us to remain competitive in obtaining funds and to respond to changes in customer demand and our liquidity needs.

Our board of directors is responsible for the review and oversight of our Asset/Liability Committee, which is comprised of our executive management team. This committee is charged with developing and implementing an asset/liability management plan, and meets at least quarterly to review pricing and liquidity needs and assess our interest rate risk. We currently utilize a third-party modeling program, prepared on a quarterly basis, to evaluate our sensitivity to changing interest rates, given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the board of directors. In addition, we regularly perform a gap analysis of the discrepancy between the repricing of our assets and liabilities.

***Economic Value of Equity.*** In order to monitor and manage interest rate risk, we use the net present value of equity at risk methodology. This methodology calculates the difference between the present value of expected cash flows from assets and liabilities. The comparative scenarios assume an immediate parallel shift in the yield curve in increments of 100 basis point (bp) rate movements. A basis point equals one-hundredth of one percent, and 100 basis points equals one percent. An increase in interest rates from 3% or 4% would mean, for example, a 100 basis point increase in the Change in Interest Rates column below. The model is run at least quarterly showing shocks from +400bp to -100bp. The board of directors and management review the methodology s measurements on a quarterly basis.

The interest rate scenarios are used for analytical purposes and do not necessarily represent management s view of future market movements. Results of the modeling are used to provide a measure of the degree of volatility interest rate movements may have on our earnings. Modeling the sensitivity of earnings to interest rate risk is decidedly reliant on numerous assumptions embedded in the model. These assumptions include, but are not limited to, management s best assessment of the effect of changing interest rates on the prepayment speeds of certain assets and liabilities, projections for account balances in each of the product lines offered and the historical behavior of deposit rates and balances in relation to changes in interest rates. These assumptions are inherently changeable, and as a result, the model is not expected to precisely measure net interest income or precisely predict the impact of fluctuations in interest rate on net interest income. Actual results will differ from the simulated results due to timing, magnitude, and frequency of interest rate changes as well as changes in market conditions. Assumptions are supported with annual back testing of the model to actual market rate shifts.

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The table below sets forth, as of June 30, 2018, the estimated changes in the net present value of equity that would result from the designated changes in the United States Treasury yield curve under an instantaneous parallel shift for the Bank. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

| | Economic Value of Equity | | | EVE as a % of Economic Value of Assets(3) | |
|---|---|---|---|---|---|
| **Change in Interest Rates (Basis Points)(1)** | **Estimated EVE (2)** | **Amount of Change** | **Percent (Dollars in thousands)** | **EVE Ratio** | **Basis Points Change (1)** |
| +400 | $ 47,718 | $ (27,016) | (36.1)% | 6.57% | (262) |
| +300 | 54,195 | (20,539) | (27.5) | 7.26 | (193) |
| +200 | 60,838 | (13,896) | (18.6) | 7.93 | (126) |
| +100 | 68,089 | (6,646) | (8.9) | 8.62 | (57) |
| 0 | 74,735 | | | 9.19 | |
| -100 | 74,118 | (617) | (0.8) | 8.88 | (31) |

(1) Assumes instantaneous parallel changes in interest rates.

(2) EVE or Economic Value of Equity at Risk measures the Bank s exposure to equity due to changes in a forecast interest rate environment.

(3) EVE ratio represents Economic Value of Equity divided by the economic value of assets which should measure changes in theoretical market value.

The table above indicates that at June 30, 2018, in the event of a 100 basis point decrease in interest rates, we would experience a 0.8% decrease in economic value of equity. In the event of a 400 basis point increase in interest rates, we would experience a 36.1% decrease in economic value of equity.

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurement. Modeling changes in the economic portfolio value of equity require making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in interest rates. In this regard, the table above 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 an instantaneous parallel change in interest rates. Furthermore, although the 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. Finally, the above table does not take into account the changes in the credit risk of our assets that can occur in connection with changes in interest rates.

Depending on the relationship between long-term and short-term interest rates, market conditions and consumer preference, we may place greater emphasis on maximizing our net interest income than on strictly matching the interest rate sensitivity of our assets and liabilities. We believe that our level of interest rate risk is acceptable using this approach.

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## Item 4 - Controls and Procedures

**Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report, the Corporation carried out an evaluation as defined in Rule 13a-15(e) under the Exchange Act of 1934, under the supervision and with the participation of the Corporation s principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Corporation s disclosure controls and procedures. Based on this evaluation, the Corporation s principal executive officer and principal financial officer concluded that the Corporation s disclosure controls and procedures are effective.

**Changes in Internal Control over Financial Reporting**

There has been no change in the Corporation s internal control over financial reporting that has occurred during the Corporation s most recent fiscal quarter (i.e., the three months ended June 30, 2018) that has materially affected, or is reasonably likely to materially affect, such internal controls.

# PART II - OTHER INFORMATION

## Item 1 - Legal Proceedings

At June 30, 2018 there were no material legal proceedings to which the Corporation is a party or of which any of its property is subject, other than disclosed below. From time to time, the Corporation is a party to various legal proceedings incident to its business.

On May 22, 2018, Fredda Sharfstein, a purported Corporation stockholder, filed a complaint in the United States District Court for the District of Maryland, captioned *Sharfstein v. Coastway Bancorp, Inc., Mark E. Crevier, Francis X. Flaherty, Debra Paul, William A. White, Dennis M. Murphy, James P. Fiore, Lynda Dickinson, Phillip Kydd, David P. DiSanto, Malcolm G. Chace, Jr. and Angelo P. Lopresti, II (Case No. 1:18-cv-01471-ELH)*, against Corporation and each Corporation director (the Individual Sharfstein Defendants ). The lawsuit alleged that the Corporation and the Individual Sharfstein Defendants violated the federal securities laws by omitting certain material information from the Corporation s definitive proxy statement for the Corporation s special stockholders meeting to approve the merger that in turn rendered affirmative statements made by Corporation false and misleading. The relief sought by the lawsuit included both a preliminary and permanent injunction against the completion of the proposed merger, rescissory damages if the proposed merger is completed, and costs, including attorneys and experts fees. The plaintiff voluntarily withdrew this lawsuit in July 2018.

On May 24, 2018, Paul Parshall, a purported Corporation stockholder, filed a complaint, on behalf of himself and all other Corporation public stockholders, of a putative class action lawsuit in the United States District Court for the District of Rhode Island, captioned *Parshall v.*

*Coastway Bancorp, Inc., Mark E. Crevier, Debra Paul, William A. White, Dennis M. Murphy, James P. Fiore, Lynda Dickinson, Phillip Kydd, David P. DiSanto, Malcolm G. Chace, Jr. and Angelo P. Lopresti, II (Case No. 1:18-cv-00279)*, against the Corporation and the certain Corporation directors noted above (collectively, the Individual Parshall Defendants ). The lawsuit alleged that the Corporation and the Individual Parshall Defendants violated the federal securities laws by omitting certain material information from Corporation s definitive proxy statement for the Corporation s special stockholders meeting to approve the merger that in turn rendered affirmative statements made by the Corporation false and misleading. The relief sought by the lawsuit included both a preliminary and permanent injunction against the completion of the proposed merger, rescission and rescissory damages if the proposed merger is completed, and costs, including attorneys and experts fees. The plaintiff voluntarily withdrew this lawsuit in July 2018.

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**Item 1A -** **Risk Factors**

No material changes in Risk Factors since the Risk Factors disclosed in the March 31, 2018 quarterly report on Form 10-Q.

**Item 2 -** **Unregistered Sales of Equity Securities and Use of Proceeds**

***a)*** ***Unregistered Sales of Equity Securities.*** None

***b)*** ***Use of Proceeds.*** None

***c)*** ***Repurchase of Equity Securities.*** None

The Corporation s Board of Directors authorized its third stock repurchase program on November 22, 2016 to acquire up to 247,459 shares, or 5.0% of the Corporation s then outstanding common stock. Repurchases will be made from time to time depending on market conditions and other factors, and will be conducted through open market or private transactions, through block trades, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. There is no guarantee as to the exact number of shares to be repurchased by the Corporation. At June 30, 2018, 101,548 shares remained available to be repurchased.

**Item 3 -** **Defaults upon Senior Securities**

Not Applicable

**Item 4 -** **Mine Safety Disclosures**

Not Applicable

**Item 5 -** **Other Information**

Not Applicable

**Item 6 - Exhibits**

EXHIBIT INDEX

| Exhibit No. | Description |
|---|---|
| 31.1* | Certification of Principal Executive Officer under Securities Exchange Act Rule 13a-14(a) |
| 31.2* | Certification of Principal Financial Officer under Securities Exchange Act Rule 13a-14(a) |
| 32* | Certification of Principal Executive Officer and Principal Financial Officer under 18 U.S.C. § 1350 Furnished Pursuant to Securities Exchange Act Rule 13a-14(b) |
| 101* | The following materials from Coastway Bancorp, Inc. s Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 were formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017, (ii) Consolidated Statements of Net Income and Comprehensive Income for the three and six months ended June 30, 2018 and 2017, (iii) Consolidated Statements of Changes in Stockholders Equity for the six months ended June 30, 2018 and (iv) Notes to Unaudited Consolidated Financial Statements. |

*Filed herewith

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

| | COASTWAY BANCORP, INC. | |
|---|---|---|
| Dated: August 2, 2018 | | |
| | By: | /s/ William A. White<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| | | /s/ Jeanette Fritz<br>Executive Vice President and<br>Chief Financial Officer<br>(Principal Financial Officer) |