

Section 1: 10-Q (10-Q)

[Table of Contents](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

or

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 September 30, 2017

Commission File Number: 001-36263

Coastway Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of
incorporation or organization)

46-4149994

(I.R.S. Employer Identification No.)

One Coastway Blvd, Warwick, Rhode Island

(Address of principal executive offices)

02886

(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. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See 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

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

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

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

As of **October 31, 2017** there were **4,392,441** shares of the issuer's common stock outstanding- par value \$0.01 per share

[Table of Contents](#)

COASTWAY BANCORP, INC. and SUBSIDIARY

Index

	<u>Page Number</u>
<u>PART I - FINANCIAL INFORMATION</u>	
Item 1	1
Financial Statements	
Consolidated Balance Sheets — September 30, 2017 and December 31, 2016 (unaudited)	1
Consolidated Statements of Net Income and Comprehensive Income -Three and nine months ended September 30, 2017 and 2016 (unaudited)	2
Consolidated Statement of Changes in Stockholders' Equity - Nine months ended September 30, 2017 (unaudited)	3
Consolidated Statements of Cash Flows - Nine months ended September 30, 2017 and 2016 (unaudited)	4
Notes to the Unaudited Consolidated Financial Statements	5
Item 2	27
Management's Discussion and Analysis of Financial Condition and Results of Operations	
Item 3	45
Quantitative and Qualitative Disclosures About Market Risk	
Item 4	46
Controls and Procedures	
<u>PART II - OTHER INFORMATION</u>	
Item 1	46
Legal Proceedings	
Item 1A	46
Risk Factors	
Item 2	46
Unregistered Sales of Equity Securities and Use of Proceeds	
Item 3	47
Defaults Upon Senior Securities	
Item 4	47
Mine Safety Disclosures	
Item 5	47
Other Information	
Item 6	47
Exhibits	
Signature page	48

[Table of Contents](#)

PART I-FINANCIAL INFORMATION

Item 1 - Financial Statements

COASTWAY BANCORP, INC. and SUBSIDIARY

Consolidated Balance Sheets
(Unaudited)

(Dollars in thousands except per share amounts)	September 30, 2017	December 31, 2016
<i>Assets</i>		
Cash and cash equivalents:		
Cash and due from banks	\$ 2,560	\$ 2,946
Interest-earning deposits	40,525	41,712
Total cash and cash equivalents	43,085	44,658
Federal Home Loan Bank stock, at cost	7,408	6,184
Loans, net of allowance for loan losses of \$2,826 and \$2,493, respectively	584,264	525,215
Loans held for sale	9,882	23,157
Premises and equipment, net	32,051	31,426
Accrued interest receivable	1,863	1,598
Foreclosed real estate	4,634	422
Bank-owned life insurance	4,553	4,452
Net deferred tax asset	1,273	925
Other assets	10,640	6,154
Total assets	<u>\$ 699,653</u>	<u>\$ 644,191</u>

Liabilities and Stockholders' Equity

Deposits:			
Interest-bearing	\$	356,050	\$ 340,352
Non-interest-bearing		112,426	106,962
Total deposits		468,476	447,314
Borrowed funds		153,000	121,250
Accrued expenses and other liabilities		7,251	7,055
Total liabilities		628,727	575,619
Commitments and contingencies (Note 6)			
Stockholders' equity:			
Preferred stock, \$0.01 par value; 20,000,000 shares authorized, none issued or outstanding at September 30, 2017 and December 31, 2016		—	—
Common stock, \$0.01 par value; 50,000,000 shares authorized; 4,392,441 and 4,403,096 issued and outstanding at September 30, 2017 and December 31, 2016, respectively		44	44
Additional paid-in capital		39,979	40,107
Retained earnings		34,549	32,186
Unearned compensation - Employee Stock Ownership Plan (ESOP)		(3,366)	(3,485)
Accumulated other comprehensive loss		(280)	(280)
Total stockholders' equity		70,926	68,572
	\$	699,653	\$ 644,191

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

[Table of Contents](#)

COASTWAY BANCORP, INC. and SUBSIDIARY
Consolidated Statements of Net Income and Comprehensive Income
(Unaudited)

(in thousands except share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Interest income:				
Interest and fees on loans	\$ 6,015	\$ 5,398	\$ 17,184	\$ 15,455
Other interest income	177	80	480	226
Total interest income	6,192	5,478	17,664	15,681
Interest expense:				
Interest on deposits	741	514	2,179	1,499
Interest on borrowed funds	446	188	963	481
Total interest expense	1,187	702	3,142	1,980
Net interest income	5,005	4,776	14,522	13,701
Provision for loan losses	100	89	313	343
Net interest income after provision for loan losses	4,905	4,687	14,209	13,358
Non-interest income:				
Customer service fees	886	834	2,586	2,408
Net gain on sales of loans and other mortgage banking income	1,023	1,473	2,866	3,624
Bank-owned life insurance income	32	31	101	95
Other income	74	64	183	140
Total non-interest income	2,015	2,402	5,736	6,267
Non-interest expenses:				
Salary and employee benefits	3,024	2,712	8,975	8,141
Occupancy and equipment	755	789	2,421	2,301
Data processing	480	454	1,435	1,301
Deposit servicing	194	314	669	758
Professional fees	207	175	607	559
FDIC insurance assessment	82	100	234	285
Advertising	60	78	253	239
Foreclosed real estate	7	54	21	96
Other general and administrative	441	478	1,364	1,375
Total non-interest expenses	5,250	5,154	15,979	15,055
Income before income taxes	1,670	1,935	3,966	4,570
Income tax expense	686	752	1,603	1,802
Net income and comprehensive income	\$ 984	\$ 1,183	\$ 2,363	\$ 2,768
Weighted average common shares outstanding-basic	4,006,332	4,112,278	4,007,624	4,290,734
Weighted average common shares outstanding-diluted	4,035,720	4,116,902	4,032,084	4,293,138

Per share information:

Basic earnings per common share	\$	0.25	\$	0.29	\$	0.59	\$	0.65
Diluted earnings per common share	\$	0.24	\$	0.29	\$	0.59	\$	0.64

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

2

[Table of Contents](#)

COASTWAY BANCORP, INC. and SUBSIDIARY
Consolidated Statement of Changes in Stockholders' Equity
Nine months ended September 30, 2017
(Unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Unearned Compensation- ESOP	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount					
Balance at December 31, 2016	4,403,096	\$ 44	\$ 40,107	\$ 32,186	\$ (3,485)	\$ (280)	\$ 68,572
Net income	—	—	—	2,363	—	—	2,363
Common stock repurchased	(19,200)	—	(333)	—	—	—	(333)
Stock-based compensation, net of awards surrendered	8,545	—	100	—	—	—	100
ESOP shares committed to be allocated (11,867 shares)	—	—	105	—	119	—	224
Balance at September 30, 2017	<u>4,392,441</u>	<u>\$ 44</u>	<u>\$ 39,979</u>	<u>\$ 34,549</u>	<u>\$ (3,366)</u>	<u>\$ (280)</u>	<u>\$ 70,926</u>

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

3

[Table of Contents](#)

COASTWAY BANCORP, INC. and SUBSIDIARY
Consolidated Statements of Cash Flows
(Unaudited)

(Dollars in thousands)	Nine months ended September 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 2,363	\$ 2,768
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	313	343
Loans originated for sale	(152,345)	(161,274)
Loans sold	168,846	155,353
Gain on sale of mortgage loans, net	(3,226)	(3,209)
Amortization of deferred loan costs	738	784
Loss on foreclosed real estate	1	94
Loss on sale of real estate held for sale	—	11
Depreciation and amortization expense	1,081	995
Income from Bank-owned life insurance	(101)	(95)
Deferred income tax expense (benefit)	(348)	201
ESOP expense	224	150
Stock-based compensation, net of awards surrendered	100	90
Net change in:		
Accrued interest receivable	(265)	(132)
Other, net	(4,504)	336
Net cash provided (used) by operating activities	<u>12,877</u>	<u>(3,585)</u>
Cash flows from investing activities:		
Purchase of and increases in certificates of deposit	—	(15)
Maturities of certificates of deposit	—	3,043
Purchase of FHLB stock	(2,062)	(2,350)
Redemption of FHLB stock	838	100
Loan originations, net of principal payments	(41,894)	(43,781)
Purchase of loans from third party originators	(22,205)	(15,150)
Proceeds from the sale of real estate held for sale	—	3,294

Proceeds from the sale of foreclosed real estate	—	416
Purchases of premises and equipment	(1,706)	(1,267)
Net cash used by investing activities	(67,029)	(55,710)
Cash flows from financing activities:		
Net increase in deposits	21,162	17,436
Net change in short-term borrowed funds	31,750	48,800
Increase in long-term borrowed funds	—	1,750
Repurchase of common stock	(333)	(4,616)
Net cash provided (used) by financing activities	52,579	63,370
Net change in cash and cash equivalents	(1,573)	4,075
Cash and cash equivalents at beginning of period	44,658	18,322
Cash and cash equivalents at end of period	\$ 43,085	\$ 22,397
Supplemental cash flow information:		
Interest paid on deposits	\$ 2,178	\$ 1,499
Interest paid on borrowed funds	947	478
Income taxes paid	2,141	1,765
Supplemental cash flow information:		
Loans transferred to foreclosed real state	3,999	211

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

[Table of Contents](#)

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.

Basis of Presentation

The consolidated financial statements include the accounts of the Corporation and its subsidiary. 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 Article 8 of 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, 2016, 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.

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. As of September 30, 2017, there is no significant difference in the comparability of the financial statements as a result of this extended transition period.

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.

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

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.

On March 30, 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-09, which is intended to improve the accounting for employee share-based payments. The ASU affects all organizations that issue share-based payment awards to their employees. The ASU, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, simplifies several aspects of the accounting for share-based payment award transactions, including:

- The income tax consequences
- Classification of awards as either equity or liabilities, and
- Classification on the statement of cash flows.

For public companies, the amendments in this ASU are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For private companies and emerging growth companies, the amendments are effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for any organization in any interim or annual period. This standard will be effective for the Corporation for the year ended December 31, 2018. The Corporation early adopted the standard as of January 1, 2017, and the impact of adoption was not material. The standard adds volatility in the effective tax rate.

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 adopt the standard. The standard will add new disclosures related to factors that influenced management's estimate, including

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

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.

(2) Loans

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

(Dollars in thousands)	September 30, 2017	December 31, 2016
Residential real estate mortgage loans:		
1-4 family	\$ 287,895	\$ 243,385
Home equity loans and lines of credit	72,350	76,175
Total residential real estate mortgage loans	360,245	319,560
Commercial:		
Commercial real estate	149,767	138,946
Commercial business	16,219	13,308
Commercial construction	14,372	10,946
SBA	40,989	39,948
Consumer	1,170	1,165
Total loans	582,762	523,873
Allowance for loan losses	(2,826)	(2,493)
Net deferred loan costs	4,328	3,835
Loans, net	<u>\$ 584,264</u>	<u>\$ 525,215</u>

Residential one- to four-family loans of \$287.9 million at September 30, 2017 and \$243.4 million at December 31, 2016 include purchased loans which were individually underwritten based on the Bank's credit standards, totaling \$77.8 million and \$67.5 million at September 30, 2017 and December 31, 2016, respectively. During the nine months ended September 30, 2017 and 2016, the Bank purchased \$21.9 million and \$15.0 million of loans at a cost of \$22.2 million and \$15.2 million, respectively. The loans purchased from third parties are located in New England, primarily Massachusetts.

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.

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

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 \$26.7 million and \$25.9 million at September 30, 2017 and December 31, 2016, 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 nine months ended September 30, 2017 and the year ended December 31, 2016.

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.

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 loans.

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:

(Dollars in thousands)	September 30, 2017				
	Commercial Real Estate	Commercial Business	Commercial Construction	SBA	Total
Pass	\$ 145,329	\$ 16,219	\$ 14,372	\$ 38,908	\$ 214,828
Loans rated 6	—	—	—	—	—
Loans rated 7	4,438	—	—	2,081	6,519
Loans rated 8	—	—	—	—	—
	<u>\$ 149,767</u>	<u>\$ 16,219</u>	<u>\$ 14,372</u>	<u>\$ 40,989</u>	<u>\$ 221,347</u>

(Dollars in thousands)	December 31, 2016				
	Commercial Real Estate	Commercial Business	Commercial Construction	SBA	Total
Pass	\$ 133,660	\$ 13,308	\$ 10,946	\$ 37,430	\$ 195,344
Loans rated 6	667	—	—	1,337	2,004
Loans rated 7	4,619	—	—	1,181	5,800
Loans rated 8	—	—	—	—	—
	<u>\$ 138,946</u>	<u>\$ 13,308</u>	<u>\$ 10,946</u>	<u>\$ 39,948</u>	<u>\$ 203,148</u>

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY

Notes to the Unaudited Consolidated Financial Statements (continued)

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 nine months and future payments are reasonably assured.

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

(Dollars in thousands)	September 30, 2017					
	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	\$ 2,132	\$ 413	\$ 161	\$ 2,706	\$ —	\$ 2,875
Home equity loans and lines of credit	528	139	60	727	—	569
Commercial real estate	—	—	692	692	—	692
Commercial business	—	32	—	32	—	—
Commercial construction	—	—	—	—	—	—
SBA	—	69	280	349	—	691
Consumer	—	—	—	—	—	—
Total gross loans	<u>\$ 2,660</u>	<u>\$ 653</u>	<u>\$ 1,193</u>	<u>\$ 4,506</u>	<u>\$ —</u>	<u>\$ 4,827</u>

December 31, 2016

(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	\$ 625	\$ 587	\$ 738	\$ 1,950	\$ —	\$ 3,662
Home equity loans and lines of credit	109	547	491	1,147	—	735
Commercial real estate	—	—	130	130	—	238
Commercial business	—	—	—	—	—	—
Commercial construction	—	—	—	—	—	—
SBA	—	148	18	166	—	18
Consumer	2	—	—	2	—	—
Total gross loans	\$ 736	\$ 1,282	\$ 1,377	\$ 3,395	\$ —	\$ 4,653

The balance of loans on non-accrual at September 30, 2017 and December 31, 2016 exceeds loans 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.

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY

Notes to the Unaudited Consolidated Financial Statements (continued)

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.

September 30, 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	\$ 5,268	\$ 5,011	\$ 4,850	\$ 161	\$ 3
Home equity loans & lines of credit	1,870	1,850	1,367	483	47
Commercial real estate	1,172	1,172	1,172	—	—
SBA	2,864	2,859	2,684	175	21
Consumer	56	56	44	12	2
Total	\$ 11,230	\$ 10,948	\$ 10,117	\$ 831	\$ 73

December 31, 2016

(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	\$ 5,978	\$ 5,628	\$ 5,493	\$ 135	\$ 19
Home equity loans & lines of credit	1,369	1,349	1,131	218	31
Commercial real estate	4,487	4,487	4,487	—	—

SBA	1,511	1,493	1,493	—	—
Consumer	13	13	—	13	3
Total	\$ 13,358	\$ 12,970	\$ 12,604	\$ 366	\$ 53

Of the \$2.9 million and \$1.5 million of impaired SBA loans at September 30, 2017 and at December 31, 2016, respectively, guaranteed portions of such loans amounted to \$2.1 million and \$1.2 million at September 30, 2017 and December 31, 2016, respectively.

11

[Table of Contents](#)

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.

(Dollars in thousands)	Three Months Ended September 30, 2017		Three Months Ended September 30, 2016	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income Recognized
Residential 1-4 family	\$ 4,792	\$ 56	\$ 5,638	\$ 45
Home equity loans & lines of credit	1,935	26	1,233	9
Commercial real estate	3,739	3	1,441	18
SBA	2,071	25	2,089	30
Consumer	56	—	14	—
Total	\$ 12,593	\$ 110	\$ 10,415	\$ 102

(Dollars in thousands)	Nine Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
Residential 1-4 family	\$ 5,055	\$ 178	\$ 5,051	\$ 136
Home equity loans & lines of credit	1,810	76	1,263	41
Commercial real estate	4,119	11	813	10
SBA	1,732	70	2,094	110
Consumer	30	—	14	—
Total	\$ 12,746	\$ 335	\$ 9,235	\$ 297

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 September 30, 2017 and December 31, 2016 were \$7.9 million and \$10.9 million, respectively. No additional funds are committed to be advanced in connection with TDR loans. TDR loans on accrual status amounted to \$6.3 million and \$8.3 million at September 30, 2017 and December 31, 2016, respectively.

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

(Dollars in thousands)	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
	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	—	\$ —	\$ —	—	\$ —	\$ —
Home equity	—	—	—	6	652	652
Commercial real estate	—	—	—	1	254	254
SBA	3	761	761	4	1,011	1,011
Consumer	—	—	—	1	44	44
Total	3	\$ 761	\$ 761	12	\$ 1,961	\$ 1,961

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 nine months ended September 30, 2017.

12

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

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

(Dollars in thousands)	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2017	
	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
Home equity	—	—	1	73
Commercial real estate	—	—	2	4,108
SBA	—	—	—	—
Total	—	\$ —	4	\$ 4,252

The troubled debt restructurings described above resulted in no charge-offs and no specific reserves for the three and nine months ended September 30, 2017. One troubled debt restructured loan subsequently defaulted within 12 months included above was transferred to foreclosed real estate during the three months ended September 30, 2017 at a fair value of \$4.2 million at September 30, 2017.

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

(Dollars in thousands)	Three Months Ended September 30, 2016			Nine Months Ended September 30, 2016		
	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	\$ 218	\$ 218
Home equity	1	25	25	4	321	321
Commercial real estate	1	4,000	4,000	1	4,000	4,000
SBA	—	—	—	1	50	50
Total	2	\$ 4,025	\$ 4,025	7	\$ 4,589	\$ 4,589

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 nine months ended September 30, 2016, respectively.

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

(Dollars in thousands)	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2016	
	Number of TDRs that defaulted	Post-modification outstanding recorded investment	Number of TDRs that defaulted	Post-modification outstanding recorded investment
Residential 1-4 family	—	\$ —	2	\$ 497
SBA	1	22	1	22
Total	1	\$ 22	3	\$ 519

The troubled debt restructurings described above resulted in no charge-offs and no specific reserves for the three and nine months ended September 30, 2016.

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:

(Dollars in thousands)	Three Months Ended September 30, 2017							
	Residential 1-4 family	Home Equity	Commercial Real Estate	Commercial Business	Commercial Construction	SBA	Consumer	Total
Allowance at June 30, 2017	\$ 1,087	\$ 523	\$ 692	\$ 69	\$ 69	\$ 273	\$ 7	\$ 2,720

impaired loans	990	510	596	60	51	228	5	2,440
Total	\$ 1,009	\$ 541	\$ 596	\$ 60	\$ 51	\$ 228	\$ 8	\$ 2,493
Impaired loans	\$ 5,628	\$ 1,349	\$ 4,487	\$ —	\$ —	\$ 1,493	\$ 13	\$ 12,970
Non-impaired loans	237,757	74,826	134,459	13,308	10,946	38,455	1,152	510,903
Total loans	\$ 243,385	\$ 76,175	\$ 138,946	\$ 13,308	\$ 10,946	\$ 39,948	\$ 1,165	\$ 523,873

(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 \$1.3 million at September 30, 2017 and \$1.1 million at December 31, 2016, 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 \$1.3 million at September 30, 2017 and \$1.1 million at December 31, 2016. Additionally, the Rabbi Trust holds 8,900 shares of Corporation stock at September 30, 2017 and December 31, 2016 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 seven 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 September 30, 2017 and 2016, SERP expense totaled \$241,000 and \$192,000, respectively, and for the nine months ended September 30, 2017 and 2016, SERP expense totaled \$723,000 and \$575,000, respectively.

Defined Benefit Pension Plan

Pension expense totaled \$8,000 and \$5,000 for the three months ended September 30, 2017 and 2016, respectively, and \$24,000 and \$16,000 for the nine months ended September 30, 2017 and 2016, respectively. The Bank expects to contribute \$8,000 during the plan year ending December 31, 2017.

[Table of Contents](#)

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 at the Conversion date. As of September 30, 2017, the ESOP holds 395,219 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 3.50% at January 1, 2017. 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:

Allocated	47,512
Distributions	(715)
Committed to be allocated	11,867
Unallocated	336,555
	<u>395,219</u>

The fair value of unallocated shares was approximately \$6.7 million at September 30, 2017.

Total expense recognized in connection with the ESOP for the three month periods ended September 30, 2017 and 2016 was \$79,000 and \$51,000, respectively, and total expense for the nine month periods ended September 30, 2017 and 2016 was \$224,000 and \$150,000, respectively.

(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.

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

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY

Notes to the Unaudited Consolidated Financial Statements (continued)

Other Stock-Based Compensation (continued)

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 September 30, 2017 and 2016 was \$34,000 and \$24,000, respectively and restricted stock expense for the nine month periods ended September 30, 2017 and 2016 was \$95,000 and \$60,000, respectively. At September 30, 2017 and 2016, there was \$489,000 and \$424,000, 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.

Stock option expense for the three months ended September 30, 2017 and 2016 was \$17,000 and \$12,000, respectively, and stock option expense for the nine month periods ended September 30, 2017 and 2016 was \$49,000 and \$30,000, respectively. At September 30, 2017 and 2016, there was \$254,000 and \$207,000, 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:

	<u>2017 Grant</u>	<u>2016 Grant</u>
Volatility	15.04%	13.52%
Forfeiture rate	00.00	00.00
Dividend yield	00.00	00.00
Expected term	8 years	8 years
Risk free interest rate	2.25%	1.56%

(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.

Earnings per common share have been computed as follows for the three months ended September 30, 2017 and 2016 and the nine months ended September 30, 2017 and 2016:

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income applicable to common stock	\$ 984	\$ 1,183	\$ 2,363	\$ 2,768
Weighted average common shares outstanding	4,344,851	4,466,634	4,350,077	4,649,024
Less: Average unallocated ESOP shares	(338,519)	(354,356)	(342,453)	(358,290)
Weighted average number of common shares outstanding — basic	4,006,332	4,112,278	4,007,624	4,290,734
Dilutive impact of stock options	17,665	—	14,380	—
Dilutive impact of restricted stock	11,723	4,624	10,080	2,404
Weighted average number of common shares outstanding — diluted	4,035,720	4,116,902	4,032,084	4,293,138
Earnings per share — basic	\$ 0.25	\$ 0.29	\$ 0.59	\$ 0.65
Earnings per share — diluted	\$ 0.24	\$ 0.29	\$ 0.59	\$ 0.64

Stock options to purchase 91,225 shares of common stock at \$12.41 per share for the three months ended September 30, 2016 were not considered in computing diluted earnings per share for the three months ended September 30, 2016 because the option exercise price was greater than the average market price of the common stock. Stock options to purchase 26,155 shares at \$16.40 per share for the nine months ended September 30, 2017 and 91,225 shares of common stock at \$12.41 per share for the nine months ended September 30, 2016, respectively, were not considered in computing diluted earnings per share for the nine

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

Earnings per Common Share (continued)

months ended September 30, 2017 and 2016, respectively because the option exercise price was greater than the average market price of the common stock.

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. During the three months and nine months ended September 30, 2017, the Corporation repurchased no and 19,200 shares under this third stock repurchase program, with 101,548 shares remaining to be repurchased under this program at September 30, 2017.

(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:

	September 30, 2017	December 31, 2016
	(In thousands)	
Commitments to originate loans for portfolio	\$ 26,476	\$ 18,461
Commitments to originate loans to be sold	33,220	24,307
Commitments to purchase loans from third parties	5,275	4,236
Unfunded commitments under home equity lines of credit	56,365	53,342
Unfunded commitments under commercial lines of credit	18,931	14,730
Unfunded commitments under SBA lines of credit	4,556	4,106
Unfunded commitments under overdraft lines of credit	182	180

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.

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

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

At September 30, 2017, the Bank had \$33.2 million of interest rate lock commitments to borrowers and loans held for sale of \$9.9 million with \$37.5 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 \$17.0 million, mandatory delivery contracts with a notional amount of \$1.5 million, and best efforts contracts with a notional amount of \$19.0 million. The Bank has \$2.3 million of closed hedge instruments that are not settled at September 30, 2017.

At December 31, 2016, the Bank had \$24.3 million of interest rate lock commitments to borrowers and loans held for sale of \$23.2 million with \$41.9 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 \$15.2 million, mandatory delivery contracts with a notional amount of \$7.4 million, and best efforts contracts with a notional amount of \$19.3 million. The Bank had \$8.5 million of closed hedge instruments that are not settled at December 31, 2016.

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. The schedule of minimum rental payments to be received under such leases as of December 31 are as follows (in thousands):

2017	\$	—
2018		182
2019		182
2020		182
2021		182
Thereafter		197
	<u>\$</u>	<u>925</u>

[Table of Contents](#)

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:

	<u>Assets</u>		<u>Liabilities</u>	
	<u>Balance Sheet Location</u>	<u>Fair Value</u>	<u>Balance Sheet Location</u>	<u>Fair Value</u>
(In thousands)				
September 30, 2017				
Derivative loan commitments				
Commitments hedged with best efforts	Other assets	\$ 203	N/A	\$ —
Commitments hedged with TBA	Other assets	297	N/A	—
Total derivative commitments		<u>500</u>	<u>N/A</u>	<u>—</u>
Forward loan sale commitments				

Best efforts contracts hedging:				
Commitments	N/A	—	Other liabilities	5
Loans held for sale	N/A	—	Other liabilities	7
Total best efforts contracts		—		12
Mandatory delivery contracts	Other assets	3	N/A	—
TBA securities	Other assets	9	N/A	—
Total forward loans sale commitments		12		12
Total derivative loan and forward loan sale commitments		\$ 512		\$ 12

December 31, 2016

Derivative loan commitments:

Commitments hedged with best efforts	Other assets	\$ 255	N/A	\$ —
Commitments hedged with TBA	Other assets	311	N/A	—
Total derivative commitments		566	N/A	—

Forward loan sale commitments

Best efforts contracts hedging:				
Commitments	N/A	—	Other liabilities	125
Loans held for sale	Other assets	77	N/A	—
Total best efforts contracts		77		125
Mandatory delivery contracts	N/A	—	Other liabilities	37
TBA securities	N/A	—	Other liabilities	57
Total forward loan sale commitments		77		219
Total derivative loan and forward loan sale commitments		\$ 643		\$ 219

[Table of Contents](#)

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		Nine Months Ended	
		September 30,		September 30,	
		2017	2016	2017	2016
		(In thousands)		(In thousands)	
Derivative loan commitments	Net gain on sales of loans and other mortgage banking income	\$ 25	\$ 162	\$ (66)	\$ 947
Best efforts contracts	Net gain (loss) on sales of loans and other mortgage banking income	(27)	(72)	36	(451)
Mandatory delivery contracts	Net gain on sales of loans and other mortgage banking income	(9)	32	40	16
TBA securities	Net gain (loss) on sales of loans and other mortgage banking income	(13)	139	66	(82)
		\$ (24)	\$ 261	\$ 76	\$ 430

(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 \$9.9 million, \$9.6 million and \$278,000 at September 30, 2017. 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 \$23.2 million, \$22.7 million and \$443,000 at December 31, 2016. 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 \$(25,000) and \$137,000 for the three months ended September 30, 2017 and 2016, respectively, and \$(164,000) and \$ 540,000 for the nine months ended September 30, 2017 and 2016, respectively.

[Table of Contents](#)

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:

(Dollars in thousands)	September 30, 2017		
	(Level 1)	(Level 2)	(Level 3)
Assets measured on a recurring basis:			
Loans held for sale	\$ —	\$ 9,882	\$ —
Derivative loan commitments hedged with best efforts	—	—	203
Derivative loan commitments hedged with TBAs	—	—	297
Forward loan sale commitments:			
TBA securities	—	9	—
Mandatory delivery contracts	—	3	—
Liabilities measured on a non-recurring basis:			
Forward loan sale commitments:			
Best efforts contracts hedging loans held for sale	—	—	7
Best efforts contracts hedging commitments	—	—	5
Assets measured on a non-recurring basis:			
Impaired loans (collateral dependent)	—	—	248
Foreclosed real estate	—	—	4,634

(Dollars in thousands)	December 31, 2016		
	(Level 1)	(Level 2)	(Level 3)
Assets measured on a recurring basis:			
Loans held for sale	\$ —	\$ 23,157	\$ —
Derivative loan commitments hedged with best efforts	—	—	255
Derivative loan commitments hedged with TBAs	—	—	311
Best efforts contracts hedging loans held for sale	—	—	77
Liabilities measured on a recurring basis:			
Forward loan sale commitments:			
Best efforts contracts — hedging commitments	—	—	125
TBA securities	—	57	—
Mandatory delivery contracts	—	37	—
Assets measured on a non-recurring basis:			
Impaired loans (collateral dependent)	—	—	558
Foreclosed real estate	—	—	422

The Bank did not have cause to transfer any assets between the fair value measurement levels during the three and nine months ended September 30, 2017 or the year ended December 31, 2016.

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 \$248,000, net of no charge-offs and \$44,000 in specific reserves at September 30, 2017. Losses related to collateral dependent impaired loans at fair value during the three and nine months ended September 30, 2017 totaled \$44,000. The provision to the allowance for loan losses related to collateral dependent impaired loans recorded at fair value for the three and nine months ended September 30,

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

Fair Value Measurements (continued)

2016 was \$44,000 and \$67,000, respectively. The carrying value of impaired loans recorded at fair value was \$558,000 net of no charge-offs and \$23,000 in specific reserves at December 31, 2016. 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. Foreclosed real estate carried at fair value at September 30, 2017 totaled \$4.6 million, comprised of \$4.2 million of real estate securing a former commercial loan and \$411,000 of a commercial building securing a former SBA loan. There were \$1,000 in losses in the three and nine months ended September 30, 2017 on foreclosed real estate held at period end and no losses for the three and nine months ended September 30, 2016.

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 nine months ended September 30, 2017 and 2016, the change in Level 3 assets and liabilities that are measured on a recurring basis:

(Dollars in thousands)	Derivative Loan Commitments and Forward Loan Sale Commitments			
	Three months ended September 30,			
	2017		2016	
Balance at beginning of period	\$	490	\$	448
Gain (losses) arising during the period		(12)		(39)
Gains on new commitments during the period		488		736
Reclassifications of realized gains (losses) on settled commitments		(478)		(607)
Balance at end of period	\$	488	\$	538

(Dollars in thousands)	Derivative Loan Commitments and Forward Loan Sale Commitments			
	Nine months ended September 30,			
	2017		2016	
Balance at beginning of period	\$	518	\$	42
Gain (losses) arising during the period		(9)		(57)
Gains on new commitments during the period		488		1,577
Reclassifications of realized gains (losses) on settled commitments		(509)		(1,024)
Balance at end of period	\$	488	\$	538

[Table of Contents](#)

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:

September 30, 2017

(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Unobservable Input Value or Range
Assets measured on a recurring basis:				
Derivative loan commitments	\$ 500	Investor pricing	Pull-through rate	75.0% – 100%
Liabilities measured on a recurring basis:				
Best efforts contracts — hedging loans held for sale	7	Investor pricing	Pull-through rate	82.5% – 100%
Best efforts contracts — hedging commitments:	5	Investor pricing	Pull-through rate	82.5% – 100%
Assets measured on a non-recurring basis:				

Impaired loans (collateral dependent)	248	Discounted appraisals	Collateral discounts	5 – 30%
Foreclosed real estate	4,634	Discounted appraisals	Collateral discounts	5 – 30%
<u>December 31, 2016</u>				
(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Unobservable Input Value or Range
Assets measured on a recurring basis:				
Derivative commitments	\$ 566	Investor pricing	Pull-through rate	75.1% – 100%
Best efforts contracts — hedging loans held for sale	77	Investor pricing	Pull-through rate	82.5% – 100%
Liabilities measured on a recurring basis:				
Forward loan sale commitments: Best efforts contracts — hedging commitments	125	Investor pricing	Pull-through rate	82.5% – 100%
Assets measured on a non-recurring basis:				
Impaired loans (collateral dependent)	558	Discounted appraisals	Collateral discounts	5 – 30%
Foreclosed real estate	422	Discounted appraisals	Collateral discounts	5 – 30%

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.

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

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY

Notes to the Unaudited Consolidated Financial Statements (continued)

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 September 30, 2017 and December 31, 2016 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.

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:

(Dollars in thousands)	September 30, 2017 (unaudited)		Fair value measurement		
	Carrying Amount	Fair Value	Level 1 inputs	Level 2 Inputs	Level 3 Inputs
Financial assets:					
Cash and cash equivalents	\$ 43,085	\$ 43,085	\$ 43,085	\$ —	\$ —
Loans, net	584,264	589,491	—	—	589,491
Loans held for sale	9,882	9,882	—	9,882	—
FHLB stock	7,408	N/A	N/A	N/A	N/A
Accrued interest receivable	1,863	1,863	—	—	1,863
Financial liabilities:					
Non-certificate accounts	303,122	303,122	303,122	—	—
Certificate accounts	165,354	165,818	—	165,818	—
Borrowed funds	153,000	152,841	—	152,841	—
Accounts interest payable	57	57	—	57	—

25

[Table of Contents](#)

COASTWAY BANCORP, INC. AND SUBSIDIARY
Notes to the Unaudited Consolidated Financial Statements (continued)

Fair Value Measurements (continued)

(Dollars in thousands)	December 31, 2016		Fair value measurement		
	Carrying Amount	Fair Value	Level 1 inputs	Level 2 Inputs	Level 3 Inputs
Financial assets:					
Cash and cash equivalents	\$ 44,658	\$ 44,658	\$ 44,658	\$ —	\$ —
Loans, net	525,215	525,822	—	—	525,822
Loans held for sale	23,157	23,157	—	23,157	—
FHLB stock	6,184	N/A	N/A	N/A	N/A
Accrued interest receivable	1,598	1,598	—	—	1,598
Financial liabilities:					
Non-certificate accounts	284,430	284,430	284,430	—	—
Certificate accounts	162,884	163,145	—	163,145	—
Borrowed funds	121,250	121,053	—	121,053	—
Accrued interest payable	40	40	—	40	—

26

[Table of Contents](#)

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 "our") consolidated financial statements and notes thereto contained in this report and the Corporation's 2016 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 statements

contained in Item 2 - "Management's Discussion and 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) 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; (vi) changes in technology could adversely impact the Corporation's operations and increase technology-related expenditures; (vii) increases in employee compensation and benefit expenses and other non-interest expenses could adversely affect the Corporation's financial results; (viii) 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; (ix) 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; (x) our ability to enter new markets successfully and capitalize on growth opportunities; (xi) future regulatory compliance costs, including any increase caused by new regulations imposed by the Consumer Finance Protection Bureau; and (xii) some or all of the risks and uncertainties described in "Risk Factors" of the Corporation's annual report on Form 10-K 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 2016 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 2016 audited consolidated financial statements.

[Table of Contents](#)

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.

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. Historically, our interest-earning assets had re-priced more quickly than our interest-bearing liabilities, which make us vulnerable to decreases 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 the first one to two years in an increasing interest rate environment, and then revert back to interest-earning assets re-pricing more quickly than our interest-bearing liabilities thereafter. 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.

Net income was \$984,000 for the three months ended September 30, 2017 as compared to net income of \$1.2 million for the three months ended September 30, 2016. The decrease in earnings for the three months ended September 30, 2017 as compared to the same period in 2016 was impacted by a decrease of \$387,000 in non-interest income and an increase of \$96,000 in non-interest expenses, partially offset by a \$229,000 increase in net interest income. Non-interest income decreased \$387,000 primarily due to a decrease of \$450,000 in net gains on sales of loans and other mortgage banking income for the three months ended September 30, 2017 as compared to the same period in 2016. A loss in the fair value of mortgage derivatives and a net change in the fair value of loans held for sale of \$232,000 was recorded during the three months ended September 30, 2017 as compared to a gain of \$22,000 during the three months ended September 30, 2016. Gains on sales of mortgage loans decreased \$200,000 to \$1.2 million for the three months ended September 30, 2017 from \$1.4 million for the three months ended September 30, 2016, 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 September 30, 2017 totaled \$61.7 million as compared to \$63.8 million during the three months ended September 30, 2016. The \$96,000 increase in non-interest expense was primarily due to an increase of \$312,000 in salary and employee benefits, and

a \$32,000 increase in professional fees, partially offset by a decrease of \$120,000 in deposit servicing expenses primarily due to a decrease in debit card costs, and a decrease of \$47,000 in foreclosed real estate expense. Net interest income increased \$229,000, or 4.8%, to \$5.0 million for the three months ended September 30, 2017 from \$4.8 million for the three months ended September 30, 2016 due to a \$13.9 million increase in net interest-earning assets to \$144.3 million for the three months ended September 30, 2017, partially offset by a decrease in our interest rate spread of 28 basis points to 2.90% for the three months ended September 30, 2017 as compared to 3.18% for the prior year period.

Net income decreased \$405,000 to \$2.4 million for the nine months ended September 30, 2017 as compared to net income of \$2.8 million for the nine months ended September 30, 2016, primarily due to an increase of \$924,000 in non-interest expense and a \$531,000 decrease in non-interest income, partially offset by an increase of \$821,000 in net interest income. Non-interest expenses increased \$924,000, or 6.1%, to \$16.0 million for the nine months ended September 30, 2017 from \$15.1 million for the nine months ended September 30, 2016. The increase in non-interest expenses was primarily due to increased salary and employee benefits expense, which increased \$834,000 for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 due to an increase in full time equivalents (“FTEs”) which totaled 150 at September 30, 2017, 144 FTEs at December 31, 2016, and 143 FTEs at September 30, 2016, general merit increases, an increase in SERP expense of \$148,000, and an increase of \$117,000 in stock-based compensation expense related to awards made under our 2015 Equity Incentive Plan and our ESOP Plan. Non-interest income decreased \$531,000, or 8.5%, to \$5.7 million for the nine months ended September 30, 2017 from \$6.3 million for the nine months ended September 30, 2016, primarily due to a decrease of \$758,000 in net gains on sales of loans and other mortgage banking income. A loss resulting from the decrease in the fair value of mortgage derivatives, commitments to sell and loans held for sale of \$422,000 was recorded during the nine months ended September 30, 2017 as compared to a gain of \$365,000 for the nine months ended September 30, 2016, resulting in a decrease of \$787,000 between periods. Gains on sales of mortgage loans increased \$17,000 and totaled \$3.2 million for the nine months ended September 30, 2017 and 2016. Mortgage loans sold during the nine months ended September 30, 2017 amounted to \$168.8 million as compared to \$155.4 million during the nine months ended September 30, 2016. The increase in the net gain on sales of mortgage loans was due to the higher volume of loans sold during the nine months ended September 30, 2017, partially offset by a decline in the net margin. Net interest income increased \$821,000, or

[Table of Contents](#)

6.0%, to \$14.5 million for the nine months ended September 30, 2017 from \$13.7 million for the nine months ended September 30, 2016 due to a \$9.6 million increase in net interest-earning assets to \$138.5 million for the nine months ended September 30, 2017 as compared to the prior year period.

Comparison of Financial Condition at September 30, 2017 and December 31, 2016

Assets. Our total assets increased \$55.5 million, or 8.6%, to \$699.7 million at September 30, 2017 from \$644.2 million at December 31, 2016 primarily due to an increase in loans held for investment. Total loans increased \$58.9 million, or 11.2%, to \$582.8 million at September 30, 2017 from \$523.9 million at December 31, 2016. The increase in total loans was primarily due to an increase in residential one- to four-family loans of \$44.5 million, or 18.3%, to \$287.9 million at September 30, 2017 from \$243.4 million at December 31, 2016. Residential one-to four-family loans increased due to purchases of \$21.9 million of loans at a purchase price of \$22.2 million from third parties as well as organic loan growth. Commercial real estate loans increased \$10.8 million, or 7.8% to \$149.8 million at September 30, 2017 as compared to \$138.9 million at December 31, 2016. Commercial construction loans increased \$3.4 million, or 31.3% to \$14.4 million at September 30, 2017. Cash and cash equivalents decreased \$1.6 million during the nine months ended September 30, 2017 primarily due to a decrease in interest-earning deposits. Loans held for sale declined \$13.3 million during the nine months ended September 30, 2017 as loan sales outpaced loan originations.

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

(Dollars in thousands)	September 30, 2017		December 31, 2016	
	Amount	Percent	Amount	Percent
Residential real estate:				
1-4 family	\$ 287,895	49.40%	\$ 243,385	46.46%
Home equity loans and lines of credit	72,350	12.42	76,175	14.54
Commercial real estate	149,767	25.70	138,946	26.52
Commercial business	16,219	2.78	13,308	2.54
Commercial construction	14,372	2.47	10,946	2.09
SBA loans	40,989	7.03	39,948	7.63
Consumer	1,170	0.20	1,165	0.22
Total loans	582,762	100.00%	523,873	100.00%
Net deferred loan costs	4,328		3,835	
Allowance for loan losses	(2,826)		(2,493)	
Total loans, net	\$ 584,264		\$ 525,215	

Deposits. Our primary source of funds is retail deposits held by individuals and businesses within our market area. Deposits increased \$21.2 million, or 4.7%, to \$468.5 million at September 30, 2017 from \$447.3 million at December 31, 2016. The increase in deposits was a result of an increase of \$6.9 million or 6.5%, in savings and interest bearing deposit accounts, an increase of \$6.1 million, or 8.7% in money market accounts, and an increase of \$2.5 million, or 1.5% in certificates of deposit accounts. The increase in certificates of deposit was primarily in the five-year maturity category. Non-interest bearing demand deposits increased \$5.5 million, or 5.1% from \$107.0 million at December 31, 2016 to \$112.4 million at September 30, 2017.

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

(Dollars in thousands)	September 30, 2017		December 31, 2016	
	Amount	Percent	Amount	Percent
Non-interest bearing demand deposits	\$ 112,426	24.00%	\$ 106,962	23.91%
Money market accounts	76,586	16.35	70,462	15.75
Savings and interest-bearing demand deposit accounts	112,533	24.02	105,675	23.63
Club accounts	1,577	0.33	1,331	0.30
Total transaction accounts	303,122	64.70	284,430	63.59
Certificates of deposit	165,354	35.30	162,884	36.41
Total deposits	\$ 468,476	100.00%	\$ 447,314	100.00%

29

[Table of Contents](#)

Borrowed Funds. We utilize borrowings from the Federal Home Loan Bank of Boston (“FHLBB”) as an alternate funding source. Borrowed funds at September 30, 2017 totaled \$153.0 million as compared to \$121.3 million at December 31, 2016, an increase of \$31.7 million, or 26.2%. Borrowed funds at September 30, 2017 were comprised of \$151.3 million of short-term advances at a weighted average rate of 1.26% as compared to short-term advances of \$119.5 million at December 31, 2016 at a weighted average rate of 0.74%. The increase in overnight advances during the nine months ended September 30, 2017 was to fund the increase in loans. Long-term FHLBB advances totaled \$1.8 million at September 30, 2017 and December 31, 2016, 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 \$70.9 million at September 30, 2017 from \$68.6 million at December 31, 2016. The increase in stockholders’ equity was due to net income of \$2.4 million, stock-based compensation of \$100,000, and \$224,000 of ESOP shares committed to be allocated, partially offset by stock repurchases of \$333,000 during the nine months ended September 30, 2017.

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 increased to \$4.8 million, or 0.83% of total loans at September 30, 2017, from \$4.7 million, or 0.89% of total loans, at December 31, 2016 primarily due to a \$454,000 increase in commercial real estate non-performing loans and a \$673,000 increase in SBA non-performing loans, partially offset by a \$787,000 decrease in non-performing one- to four-family residential loans. A restructured residential one- to four-family loan with a balance of \$213,000 was moved to performing status in 2017 due to satisfactory payment performance, while three non-performing residential loans totaling \$1.1 million were paid off during the nine months ended September 30, 2017. Two new loans totaling \$587,000 were added to non-performing one- to four-family residential loans during the nine months ended September 30, 2017. A home equity loan of \$110,000 was paid off during the three months ended September 30, 2017. Commercial real estate non-performing loans increased \$454,000 due to the addition of a \$584,000 loan, partially offset by a payoff of an \$130,000 loan during the nine months ended September 30, 2017. SBA non-performing loans increased \$673,000 primarily due to the addition of two loans totaling \$530,000.

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. Foreclosed real estate was \$4.6 million at September 30, 2017 and \$422,000 at December 31, 2016. A \$4.0 million troubled debt restructured commercial real estate loan was transferred to foreclosed real estate during the nine months ended September 30, 2017. Non-performing assets increased \$4.4 million during the nine months ended September 30, 2017 from \$5.1 million at December 31, 2016 to \$9.5 million at September 30, 2017 due to the increase in non-performing loans and foreclosed real estate discussed above.

30

Accruing Troubled Debt Restructured Loans

Accruing troubled debt restructurings totaled \$6.1 million at September 30, 2017, a decrease of \$2.2 million from \$8.3 million at December 31, 2016. The decrease in accruing troubled debt restructurings was primarily due to a \$4.0 million troubled debt restructured commercial real estate loan which was transferred to foreclosed real estate, partially offset by one one-to four family residential loan of \$211,000 which was moved from non-performing to accruing status, five restructured home equity loans and lines of credit that totaled \$522,000, one commercial real estate loan which totaled \$259,000 and three SBA loans to one borrower totaling \$761,000 entered into during the nine months ended September 30, 2017.

[Table of Contents](#)

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)	September 30, 2017	December 31, 2016
Nonaccrual loans:		
Residential real estate mortgage loans:		
1-4 family	\$ 1,631	\$ 1,629
Home equity loans and lines of credit	325	316
Commercial real estate loans	584	130
Commercial business loans	—	—
SBA loans	691	18
Commercial construction loans	—	—
Consumer loans	—	—
Total nonaccrual loans	3,231	2,093
Non-accruing troubled debt restructured loans:		
Residential real estate mortgage loans:		
1-4 family	1,244	2,033
Home equity loans and lines of credit	244	419
Commercial real estate loans	108	108
Commercial business loans	—	—
SBA loans	—	—
Commercial construction loans	—	—
Consumer loans	—	—
Total non-accruing troubled debt restructured loans	1,596	2,560
Total nonperforming loans	4,827	4,653
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	411	422
Commercial construction loans	—	—
Consumer loans	—	—
Total foreclosed real estate	4,634	422
Total nonperforming assets	\$ 9,461	\$ 5,075
Total accruing troubled debt restructured loans	\$ 6,121	\$ 8,316
Delinquent loans 60 — 89 days past due	\$ 653	\$ 1,282
Ratios:		
Loans 60-89 days past due to total loans	0.11%	0.24%
Non-performing loans to total loans	0.83%	0.89%
Non-performing assets to total assets	1.35%	0.79%

For the three months ended September 30, 2017 and 2016, gross interest income which would have been recorded had the non-performing loans been current in accordance with their original terms amounted to \$46,000 and \$40,000, respectively. The

[Table of Contents](#)

amount that was included in interest income on such loans totaled \$44,000 and \$17,000 for the three months ended September 30, 2017 and 2016, respectively. For the nine months ended September 30, 2017 and 2016, gross interest income that would have been recorded had the non-

performing loans been current in accordance with their original terms was \$133,000 and \$171,000, respectively. The amount that was included in interest income on such loans totaled \$136,000 and \$103,000 for the nine months ended September 30, 2017 and 2016, 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)	September 30, 2017	December 31, 2016
Special mention	\$ —	\$ 2,004
Substandard	6,519	5,800
Doubtful	—	—
Loss	—	—
Total classified and special mention loans	\$ 6,519	\$ 7,804

The level of classified and special mention loans decreased by \$1.3 million to \$6.5 million at September 30, 2017 from \$7.8 million at December 31, 2016. Special mention loans decreased \$2.0 million from December 31, 2016. Five loans totaling \$829,000 were upgraded to pass rated loans that were previously classified as “special mention”, two loans totaling \$115,000 were paid off, and two loans totaling \$864,000 were downgraded to “substandard”. “Substandard” loans increased \$719,000 from December 31, 2016 primarily due to the downgrade of three performing loans to one borrower totaling \$3.1 million primarily due to operating losses; the downgrade of three loans totaling \$761,000 to one borrower due to closure of the related business; the downgrade of \$864,000 of loans from “special mention” to “substandard”, and the downgrade of one other loan totaling \$250,000, partially offset by the transfer of one commercial real estate loan totaling \$4.0 million to foreclosed real estate in September 2017.

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.

[Table of Contents](#)

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 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.

34

[Table of Contents](#)

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

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Balance at beginning of period	\$ 2,720	\$ 2,374	\$ 2,493	\$ 2,194
Provision for loan losses	100	89	313	343
Charge-offs:				
Residential 1-4 family	—	—	(6)	(20)
Home equity loans and lines of credit	—	—	—	(67)
Commercial real estate loans	—	—	—	—
Commercial business loans	—	—	—	—
SBA	—	(17)	—	(30)
Commercial construction	—	—	—	—
Consumer	—	—	—	—
Total charge-offs	—	(17)	(6)	(117)
Recoveries on charged-off loans				
Residential 1-4 family	—	5	6	5
Home equity loans and lines of credit	1	2	3	10
Commercial real estate loans	—	—	—	—
Commercial business loans	—	—	—	—
SBA	2	—	5	9
Commercial construction	—	—	—	—
Consumer	3	3	12	12
Total recoveries	6	10	26	36
Net (charge-offs) recoveries	6	(7)	20	(81)
Balance at end of period	\$ 2,826	\$ 2,456	\$ 2,826	\$ 2,456
Annualized net loans (charge-offs) recoveries to average loans outstanding	0.00%	(0.01)%	0.00%	(0.02)%
Allowance for loan losses to non-performing loans at end of period	58.55%	48.96%	58.55%	48.96%
Allowance for loan losses to total loans at end of period	0.48%	0.47%	0.48%	0.47%

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.

35

[Table of Contents](#)

Comparison of Operating Results for the Three Months Ended September 30, 2017 and September 30, 2016.

General. Net income was \$984,000 for the three months ended September 30, 2017 as compared to net income of \$1.2 million for the three months ended September 30, 2016. The decrease in earnings for the three months ended September 30, 2017 as compared to the same period in 2016 was impacted by a decrease of \$387,000 in non-interest income and an increase of \$96,000 in non-interest expenses, partially offset by a \$229,000 increase in net interest income. Non-interest income decreased \$387,000 primarily due to a decrease of \$450,000 in net gains on sales of loans and other mortgage banking income for the three months ended September 30, 2017 as compared to the same period in 2016. A loss in the

fair value of mortgage derivatives and a net change in the fair value of loans held for sale of \$232,000 was recorded during the three months ended September 30, 2017 as compared to a gain of \$22,000 during the three months ended September 30, 2016. Gains on sales of mortgage loans decreased \$200,000 to \$1.2 million for the three months ended September 30, 2017 from \$1.4 million for the three months ended September 30, 2016, 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 September 30, 2017 totaled \$61.7 million as compared to \$63.8 million during the three months ended September 30, 2016. The \$96,000 increase in non-interest expense was primarily due to an increase of \$312,000 in salary and employee benefits, and a \$32,000 increase in professional fees, partially offset by a decrease of \$120,000 in deposit servicing expenses primarily due to a decrease in debit card costs, and a decrease of \$47,000 in foreclosed real estate expense. Net interest income increased \$229,000, or 4.8%, to \$5.0 million for the three months ended September 30, 2017 from \$4.8 million for the three months ended September 30, 2016 due to a \$13.9 million increase in net interest-earning assets to \$144.3 million for the three months ended September 30, 2017, partially offset by a decrease in our interest rate spread of 28 basis points to 2.90% for the three months ended September 30, 2017 as compared to 3.18% for the prior year period.

Interest Income. Interest income increased \$714,000, or 13.0%, to \$6.2 million for the three months ended September 30, 2017 from \$5.5 million for the three months ended September 30, 2016. The increase reflected an increase in the average balance of interest-earning assets of \$66.1 million to \$637.1 million for the three months ended September 30, 2017 as compared to \$571.0 million for the three months ended September 30, 2016, and an increase in the average yield on interest-earning assets to 3.86% for the three months ended September 30, 2017 as compared to 3.82% for the three months ended September 30, 2016. The majority of our interest income was derived from interest and fees on loans. The average yield on interest-earning assets increased by four basis points to 3.86% due to the nine basis points increase in the average loan yield and the \$47.3 million increase in average loans and loans held for sale during the three months ended September 30, 2017 as compared to the same prior year period.

Interest and fees on loans increased \$617,000, or 11.4%, to \$6.0 million for the three months ended September 30, 2017 from \$5.4 million for the three months ended September 30, 2016. Interest and fees on loans increased due to an increase in the average balance of loans and loans held for sale of \$47.3 million to \$589.6 million for the three months ended September 30, 2017 as compared to \$542.3 million for the three months ended September 30, 2016. 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 4.05% for the three months ended September 30, 2017 from 3.96% for the three months ended September 30, 2016 primarily due to an increase in market interest rates.

Interest income on cash and cash equivalents and increased \$88,000 to \$114,000 for the three months ended September 30, 2017 from \$26,000 for the three months ended September 30, 2016 due primarily to the \$22.2 million increase in average cash and cash equivalents as we increased our on-balance sheet liquidity, coupled with a 55 basis points increase in the average yield.

Interest Expense. Interest expense increased \$485,000, or 69.1%, to \$1.2 million for the three months ended September 30, 2017 from \$702,000 for the three months ended September 30, 2016 primarily due to a \$216,000 increase in interest expense on certificates of deposit. Interest expense on certificates of deposit increased \$216,000 due primarily to an increase of \$51.6 million in the average balance of certificates of deposit during the three months ended September 30, 2017 as compared to the same prior year period. During the fourth quarter of 2016, we obtained \$44.4 million of certificates of deposit through a nationwide on-line service (“national market”), with the remainder of the increase due to organic growth. The average rate paid to certificate of deposit holders increased six basis points to 1.51% for the three months ended September 30, 2017 from 1.45% for the three months ended September 30, 2016 due to an increase in the average balance of longer duration certificates of deposit.

Interest expense on borrowed funds increased \$258,000 to \$446,000 for the three months ended September 30, 2017 from \$188,000 for the three months ended September 30, 2016 due to a 76 basis points increase in the average cost of funds as short-term interest rates increased in December 2016, March 2017 and June 2017. The average balance of borrowed funds decreased \$10.5 million to \$141.5 million for the three months ended September 30, 2017 from \$152.0 million for the three

[Table of Contents](#)

months ended September 30, 2016, as we decreased average short-term borrowings as a result of the average loan sale volume outpacing new loans originated for sale.

Net Interest Income. Net interest income increased \$229,000, or 4.8%, to \$5.0 million for the three months ended September 30, 2017 from \$4.8 million for the three months ended September 30, 2016. This increase was due to a \$13.9 million increase in net interest-earning assets to \$144.3 million for the three months ended September 30, 2017, partially offset by a decrease in our interest rate spread of 28 basis points to 2.90% for the three months ended September 30, 2017 as compared to 3.18% for the prior year period. The net interest margin decreased 21 basis points to 3.12% for the three months ended September 30, 2017 from 3.33% for the three months ended September 30, 2016.

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.

(Dollars in thousands)	Increase (decrease) due to		
	Net Change	Volume	Rate
Interest-earning assets:			
Loans and loans held for sale	\$ 617	\$ 487	\$ 130
Cash and cash equivalents	88	48	40
Federal Home Loan Bank of Boston stock and other investments	9	(22)	31
Total interest-earning assets	<u>714</u>	<u>513</u>	<u>201</u>
Interest-bearing liabilities:			
Money Market accounts	8	7	1
Savings accounts	2	1	1
Club accounts	1	—	1
Certificates of deposit	216	198	18
Borrowed funds	258	(12)	270
Total interest-bearing liabilities	<u>485</u>	<u>194</u>	<u>291</u>
Net interest income	<u>\$ 229</u>	<u>\$ 319</u>	<u>\$ (90)</u>

The following table sets forth average balance sheets, average yields and costs, and certain other information for the three months ended September 30, 2017 and 2016. 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.

[Table of Contents](#)

AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS

(Dollars in thousands)	Three months ended September 30, 2017			Three months ended September 30, 2016		
	Average Balance	Interest	Average Yield(4)	Average Balance	Interest	Average Yield(4)
Assets:						
Loans and loans held for sale	\$ 589,568	\$ 6,015	4.05%	\$ 542,288	\$ 5,398	3.96%
Cash and cash equivalents	40,814	114	1.11%	18,588	26	0.56%
Federal Home Loan Bank of Boston stock and other investments	6,725	63	3.72%	10,087	54	2.13%
Total interest-earning assets	<u>637,107</u>	<u>6,192</u>	<u>3.86%</u>	<u>570,963</u>	<u>5,478</u>	<u>3.82%</u>
Non-interest-earning assets	43,110			41,610		
Total assets	<u>\$ 680,217</u>			<u>\$ 612,573</u>		
Liabilities and Equity:						
Money market accounts	\$ 74,939	80	0.42%	\$ 68,740	72	0.42%
Savings accounts	108,667	27	0.10%	103,794	25	0.10%
Club accounts	1,534	1	0.26%	1,535	—	—%
Certificates of deposit	166,149	633	1.51%	114,516	417	1.45%
Total interest-bearing deposits	<u>351,289</u>	<u>741</u>	<u>0.84%</u>	<u>288,585</u>	<u>514</u>	<u>0.71%</u>
Borrowed funds	141,493	446	1.25%	151,990	188	0.49%
Total interest bearing liabilities	<u>492,782</u>	<u>1,187</u>	<u>0.96%</u>	<u>440,575</u>	<u>702</u>	<u>0.63%</u>
Non-interest bearing deposits	110,180			95,686		
Other liabilities	7,383			8,145		
Total liabilities	<u>610,345</u>			<u>544,406</u>		
Stockholders' equity	69,872			68,167		
Total liabilities and stockholders' equity	<u>\$ 680,217</u>			<u>\$ 612,573</u>		
Net interest income		<u>\$ 5,005</u>			<u>\$ 4,776</u>	
Net interest rate spread(1)			2.90%			3.18%
Net interest-earning assets(2)	\$ 144,325			\$ 130,388		
Net interest margin(3)			3.12%			3.33%
Average interest-earning assets to interest-bearing liabilities			129.29%			129.59%

(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.

[Table of Contents](#)

Provision for loan losses. A provision for loan losses of \$100,000 was recorded to the allowance for loan losses during the three months ended September 30, 2017, an increase of \$11,000 as compared to a provision of \$89,000 for the three months ended September 30, 2016. During the three months ended September 30, 2017, a provision of \$72,000 was recorded relating to the residential one-to four- family loan portfolio primarily due to loan growth and a provision of \$35,000 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 a credit provision of \$24,000 for the three months ended September 30, 2017 relating to the SBA portfolio primarily due to a decrease in general reserves on loans risk rated “special mention” and “substandard.” We recorded net recoveries of \$6,000 for the three months ended September 30, 2017. Our provisions are based on our assessment of loss history, current asset quality and economic trends.

A provision for loan losses of \$89,000 was recorded to the allowance for loan losses during the three months ended September 30, 2016. During the three months ended September 30, 2016, a provision of \$60,000 was recorded to the residential one- to four-family loan portfolio, a provision of \$18,000 was recorded to the commercial real estate loan portfolio and an \$18,000 provision was recorded for the commercial construction portfolio all primarily due to loan growth.

Non-Interest income. Non-interest income decreased \$387,000, or 16.1%, to \$2.0 million for the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. The \$387,000 decrease was primarily due to a decrease of \$450,000 in net gains on sales of loans and other mortgage banking income for the three months ended September 30, 2017 as compared to the same period in 2016, partially offset by an increase of \$52,000 in customer service fees. A loss in the fair value of mortgage derivatives and net change in the fair value of loans held for sale of \$232,000 was recorded during the three months ended September 30, 2017 as compared to a gain of \$22,000 during the three months ended September 30, 2016. Gains on sales of mortgage loans decreased \$200,000 to \$1.2 million for the three months ended September 30, 2017 from \$1.4 million for the three months ended September 30, 2016, 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 September 30, 2017 totaled \$61.7 million as compared to \$63.8 million during the three months ended September 30, 2016. Customer service fees increased \$52,000 primarily due to an increase in VISA and ATM fees.

Non-Interest expense. Non-interest expense increased \$96,000, or 1.9%, to \$5.3 million for the three months ended September 30, 2017 from \$5.2 million for the three months ended September 30, 2016. The \$96,000 increase in non-interest expense was primarily due to an increase of \$312,000 in salary and employee benefits expense, and a \$32,000 increase in professional fees, partially offset by a decrease of \$120,000 in deposit servicing expenses primarily due to a decrease in debit card costs, and a decrease of \$47,000 in foreclosed real estate expenses. The \$312,000 increase in salary and employee benefits expense for the three months ended September 30, 2017 as compared to the three months ended September 30, 2016 was primarily due to an increase of 7 FTEs, a \$49,000 increase in SERP expense, general merit increases, and a \$40,000 increase in stock-based compensation related to awards made under our 2015 Equity Incentive Plan and our ESOP. The increase in FTEs was primarily due to additional employees needed primarily due to loan volume. Professional fees increased \$32,000 due to an increase in legal expenses.

Income tax expense. Income tax expense of \$686,000 was recorded for the three months ended September 30, 2017, a decrease of \$66,000, or 8.8%, as compared to \$752,000 of income tax expense for the three months ended September 30, 2016. The decrease in income tax expense was primarily due to a decrease in pre-tax income of \$265,000 during the three months ended September 30, 2017 as compared to the three months ended September 30, 2016. The effective tax rates for the three months ended September 30, 2017 and 2016 were 41.1% and 38.9%, respectively. The increase in the effective tax rate was due to the income tax 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 three months ended September 30, 2017 as compared to the three months ended September 30, 2016.

Comparison of Operating Results for the Nine Months Ended September 30, 2017 and September 30, 2016

General. Net income decreased \$405,000 to \$2.4 million for the nine months ended September 30, 2017 as compared to net income of \$2.8 million for the nine months ended September 30, 2016, primarily due to an increase a \$924,000 non-interest expense and a \$531,000 decrease in non-interest income, partially offset by an increase of \$821,000 in net interest income. Non-interest expenses increased \$924,000, or 6.1%, to \$16.0 million for the nine months ended September 30, 2017 from \$15.1 million for the nine months ended September 30, 2016. The increase in non-interest expenses was primarily due to increased salary and employee benefits expense, which increased \$834,000 for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 due to an increase in full time equivalents (“FTEs”) which totaled 150 at September 30, 2017, 144 FTEs at December 31, 2016, and 143 FTEs at September 30, 2016, general merit increases, an increase in SERP expense of \$148,000, and an increase of \$117,000 in stock-based compensation expense related to awards made under our 2015 Equity Incentive Plan and our ESOP Plan. Non-interest income decreased \$531,000, or 8.5%, to \$5.7 million for the nine months ended September 30, 2017 from \$6.3 million for the nine months ended September 30, 2016, primarily due to a decrease of \$758,000 in net gains on sales of loans and other mortgage banking income. A loss resulting

[Table of Contents](#)

from the decrease in the fair value of mortgage derivatives, commitments to sell and loans held for sale of \$422,000 was recorded during the nine

months ended September 30, 2017 as compared to a gain of \$365,000 for the nine months ended September 30, 2016, resulting in a decrease of \$787,000 between periods. Gains on sales of mortgage loans increased \$17,000 and totaled \$3.2 million for the nine months ended September 30, 2017 and 2016. Mortgage loans sold during the nine months ended September 30, 2017 amounted to \$168.8 million as compared to \$155.4 million during the nine months ended September 30, 2016. The increase in the net gain on sales of mortgage loans was due to the higher volume of loans sold during the nine months ended September 30, 2017, partially offset by a decline in the net margin. Net interest income increased \$821,000, or 6.0%, to \$14.5 million for the nine months ended September 30, 2017 from \$13.7 million for the nine months ended September 30, 2016 due to a \$9.6 million increase in net interest-earning assets to \$138.5 million for the nine months ended September 30, 2017 as compared to the prior year period.

Interest Income. Interest income increased \$2.0 million, or 12.6%, to \$17.7 million for the nine months ended September 30, 2017 from \$15.7 million for the nine months ended September 30, 2016. The increase reflected an increase in the average balance of interest-earning assets of \$63.6 million to \$608.7 million for the nine months ended September 30, 2017 as compared to \$545.0 million for the nine months ended September 30, 2016. The average yield on interest-earning assets increased slightly to 3.88% for the nine months ended September 30, 2017 as compared to 3.84% for the nine months ended September 30, 2016. The majority of our interest income was derived from interest and fees on loans.

Interest and fees on loans increased \$1.7 million, or 11.2%, to \$17.2 million for the nine months ended September 30, 2017 from \$15.5 million for the nine months ended September 30, 2016. Interest and fees on loans increased due to an increase in the average balance of loans and loans held for sale of \$45.3 million to \$564.0 million for the nine months ended September 30, 2017 as compared to \$518.7 million for the nine months ended September 30, 2016. 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 nine months ended September 30, 2017 as compared to the prior year period. Our average yield on loans increased to 4.07% for the nine months ended September 30, 2017 as compared to 3.98% for the nine months ended September 30, 2016 primarily due to an increase in market interest rates.

Interest income on cash and cash equivalents increased \$202,000 to \$278,000 for the nine months ended September 30, 2017 from \$76,000 for the nine months ended September 30, 2016 primarily due to the \$22.5 million increase in average cash and cash equivalents as we increased our on-balance sheet liquidity, coupled with a 33 basis points increase in the average yield.

Interest Expense. Interest expense increased \$1.2 million, or 58.7%, to \$3.1 million for the nine months ended September 30, 2017 from \$2.0 million for the nine months ended September 30, 2016 primarily due to an increase of \$659,000 in interest expense on certificates of deposit.

Interest expense on certificates of deposit increased \$659,000 primarily due to an increase of \$53.1 million in the average balance of certificates of deposit during the nine months ended September 30, 2017 as compared to the prior year period. During the fourth quarter of 2016, \$44.4 million of certificates of deposit were obtained through the national market, with the remainder of the increase due to organic growth. The average rate paid to certificate of deposit holders increased seven basis points to 1.51% for the nine months ended September 30, 2017 from 1.44% for the nine months ended September 30, 2016 due to an increase in the average balance of longer duration certificates of deposit.

Interest expense on borrowed funds increased \$482,000 to \$963,000 for the nine months ended September 30, 2017 from \$481,000 for the nine months ended September 30, 2016 primarily due to an increase in the average cost of borrowed funds. The average cost of borrowed funds increased 56 basis points to 1.05% for the nine months ended September 30, 2017 from 49 basis points for the nine months ended September 30, 2016, due to the increase in short-term interest rates. The average balance of borrowed funds decreased \$9.3 million to \$123.1 million for the nine months ended September 30, 2017 from \$132.4 million for the nine months ended September 30, 2016, as we decreased short-term average borrowings as average loan sale volume outpaced new average loan originations.

Net Interest Income. Net interest income increased \$821,000, or 6.0%, to \$14.5 million for the nine months ended September 30, 2017 from \$13.7 million for the nine months ended September 30, 2016. This increase was due to a \$9.6 million increase in net interest-earning assets to \$138.5 million for the nine months ended September 30, 2017 as compared to the prior year period. This increase was partially offset by a decrease in our interest rate spread of 22 basis points to 2.99% for the nine months ended September 30, 2017 as compared to 3.21% for the prior year period. The net interest margin decreased to 3.19% for the nine months ended September 30, 2017 from 3.36% for the nine months ended September 30, 2016.

[Table of Contents](#)

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.

	Nine months ended September 30, 2017 vs. 2016		
	Increase (decrease) due to		
(Dollars in thousands)	Net Change	Volume	Rate
Interest-earning assets:			
Loans and loans held for sale	\$ 1,729	\$ 1,392	\$ 337
Cash and cash equivalents	202	196	6
Federal Home Loan Bank of Boston stock and other investments	52	(79)	131

Total interest-earning assets	1,983	1,509	474
Interest-bearing liabilities:			
Money Market accounts	15	12	3
Savings accounts	6	5	1
Club accounts	—	—	—
Certificates of deposit	659	602	57
Borrowed funds	482	(31)	513
Total interest-bearing liabilities	1,162	588	574
Net interest income	\$ 821	\$ 928	\$ (107)

The following table sets forth average balance sheets, average yields and costs, and certain other information for the nine months ended September 30, 2017 and 2016. 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.

41

[Table of Contents](#)

AVERAGE BALANCES, INTEREST AND AVERAGE YIELDS

(Dollars in thousands)	Nine months ended September 30, 2017			Nine months ended September 30, 2016		
	Average Balance	Interest	Average Yield(4)	Average Balance	Interest	Average Yield(4)
Assets:						
Loans and loans held for sale	\$ 564,000	\$ 17,184	4.07%	\$ 518,671	\$ 15,455	3.98%
Cash and cash equivalents	38,552	278	0.96%	16,065	76	0.63%
Federal Home Loan Bank of Boston stock and other investments	6,126	202	4.41%	10,303	150	1.94%
Total interest-earning assets	608,678	17,664	3.88%	545,039	15,681	3.84%
Non-interest-earning assets	44,007			41,261		
Total assets	\$ 652,685			\$ 586,300		
Liabilities and Equity:						
Money market accounts	\$ 73,199	232	0.42%	\$ 69,314	217	0.42%
Savings accounts	106,901	78	0.10%	100,505	72	0.10%
Club accounts	1,461	1	0.09%	1,467	1	0.09%
Certificates of deposit	165,525	1,868	1.51%	112,445	1,209	1.44%
Total interest-bearing deposits	347,086	2,179	0.84%	283,731	1,499	0.71%
Borrowed funds	123,140	963	1.05%	132,409	481	0.49%
Total interest bearing liabilities	470,226	3,142	0.89%	416,140	1,980	0.64%
Non-interest bearing deposits	106,253			93,468		
Other liabilities	7,098			7,073		
Total liabilities	583,577			516,681		
Stockholders' equity	69,108			69,619		
Total liabilities and stockholders' equity	\$ 652,685			\$ 586,300		
Net interest income		\$ 14,522			\$ 13,701	
Net interest rate spread(1)			2.99%			3.21%
Net interest-earning assets(2)	\$ 138,452			\$ 128,899		
Net interest margin(3)			3.19%			3.36%
Average interest-earning assets to interest-bearing liabilities			129.44%			130.97%

- (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.

42

[Table of Contents](#)

Provision for loan losses. A provision of \$313,000 was recorded during the nine months ended September 30, 2017. We recorded \$150,000 of the provision for the nine months ended September 30, 2017 related to the residential one- to four-family loan portfolio primarily due to loan growth and \$131,000 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 credit provision of \$11,000 for the nine months ended September 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 \$20,000 for the nine months ended September 30, 2017.

A provision for loan losses of \$343,000 was recorded to the allowance for loan losses during the nine months ended September 30, 2016, principally due to loan growth in the residential and commercial loan categories. During the nine months ended September 30, 2016, a provision of \$163,000 was recorded relating to the residential one- to four-family loan portfolio, a provision of \$56,000 was recorded related to the commercial real estate portfolio, a provision of \$30,000 was recorded to the commercial business portfolio and a provision of \$34,000 was recorded to the commercial construction portfolio primarily due to loan growth. We recorded a provision of \$58,000 on the home equity portfolio during the nine months ended September 30, 2016. Net charge-offs of \$57,000 on the home equity loan portfolio were recorded during the nine months ended September 30, 2016.

Non-Interest income. Non-interest income decreased \$531,000, or 8.5%, to \$5.7 million for the nine months ended September 30, 2017 from \$6.3 million for the nine months ended September 30, 2016. The decrease in non-interest income was primarily due to a decrease of \$758,000 in net gains on sales of loans and other mortgage banking income. A loss resulting from the decrease in the fair value of mortgage derivatives, commitments to sell and loans held for sale of \$422,000 was recorded during the nine months ended September 30, 2017 as compared to a gain of \$365,000 for the nine months ended September 30, 2016, resulting in a decrease of \$787,000 between periods. Gains on sales of mortgage loans increased \$17,000 and totaled \$3.2 million for the nine months ended September 30, 2017 and 2016. Mortgage loans sold during the nine months ended September 30, 2017 amounted to \$168.8 million as compared to \$155.4 million during the nine months ended September 30, 2016. The increase in the net gain on sales of mortgage loans was due to the higher volume of loans sold during the nine months ended September 30, 2017, partially offset by a decline in the net margin. Customer service fees increased \$178,000 to \$2.6 million for the nine months ended September 30, 2017 from \$2.4 million for the nine months ended September 30, 2016 primarily due to higher VISA and ATM fees.

Non-Interest expenses. Non-interest expenses increased \$924,000, or 6.1%, to \$16.0 million for the nine months ended September 30, 2017 from \$15.1 million for the nine months ended September 30, 2016. The increase in non-interest expenses was primarily due to increased salary and employee benefits expense, which increased \$834,000 for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016 due to an increase in FTEs which totaled 150 at September 30, 2017, 144 FTEs at December 31, 2016, and 143 FTEs at September 30, 2016, general merit increases, an increase in SERP expense of \$148,000, and an increase of \$117,000 in stock-based compensation expense related to awards made under our 2015 Equity Incentive Plan and our ESOP Plan.

Occupancy expense increased \$120,000 to \$2.4 million for the nine months ended September 30, 2017 from \$2.3 million for the nine months ended September 30, 2016 due to snow removal costs and landscaping costs, and \$85,000 of increased depreciation expense. Data processing expense increased \$134,000 to \$1.4 million for the nine months ended September 30, 2017 from \$1.3 million for the same period in 2016, due to an increase in software expense of \$39,000 as well as cost of service increases. Deposit servicing expense decreased \$89,000 to \$669,000 for the nine months ended September 30, 2017 from \$758,000 for the same period in 2016 primarily due to decreased debit card expenses. Professional fees increased \$48,000 to \$607,000 during the nine months ended September 30, 2017 as compared to the prior year period primarily due to increased legal and audit fees. FDIC insurance expense decreased \$51,000 due to a lower FDIC assessment rate. Foreclosed real estate expense declined \$75,000 to \$21,000 during the nine months ended September 30, 2017 as compared to the prior year period primarily due to a decrease in the provision for foreclosed real estate.

Income tax expense. Income tax expense of \$1.6 million was recorded for the nine months ended September 30, 2017, a decrease of \$199,000, as compared to \$1.8 million of income tax expense for the nine months ended September 30, 2016. The decrease in income tax expense was primarily due to a decrease of \$604,000 in pre-tax income during the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016. The effective tax rate for the nine months ended September 30, 2017 was 40.4% as compared to 39.4% for the nine months ended September 30, 2016.

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 to satisfy our short- and long-term liquidity needs as of September 30, 2017.

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 September 30, 2017, cash and cash equivalents totaled \$43.1 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 September 30, 2017, the Bank had \$59.7 million in commitments to originate loans, \$33.2 million of which will be sold. In addition to commitments to originate loans, the Bank had \$80.0 million in unused lines of credit to borrowers. Commitments to purchase loans from third parties totaled \$5.3 million at September 30, 2017. Certificates of deposit due within one year of September 30, 2017 totaled \$52.5 million, or 11.1%, of total deposits, of which \$14.4 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 \$20.4 million as of September 30, 2017. 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 September 30, 2018. 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 September 30, 2017.

The Corporation's primary investing activity is originating loans. During the nine months ended September 30, 2017 and for the year ended December 31, 2016, loan originations, net of principal repayments totaled \$41.9 million, and \$42.6 million, respectively. During the nine months ended September 30, 2017 and the year ended December 31, 2016, purchases of loans from third party originators totaled \$22.2 million and \$17.8 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 \$21.2 million and \$73.8 million for the nine months ended September 30, 2017 and for the year ended December 31, 2016, 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 \$31.8 million during the nine months ended September 30, 2017 as compared to an increase of \$4.0 million for the year ended December 31, 2016 and \$1.8 million in long-term advances for the year ended December 31, 2016. The Corporation repurchased \$333,000 of its common stock as part of a previously announced 5% stock repurchase program during the nine months ended September 30, 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 \$153.0 million and \$121.3 million at September 30, 2017 and December 31, 2016, respectively. At September 30, 2017, we had the ability to borrow up to an additional \$84.2 million from the Federal Home Loan Bank of Boston. We also have the ability to borrow with the Federal Reserve discount window. At September 30, 2017, the Bank had the capacity to borrow up to \$16.8 million from the Federal Reserve discount window, but had no outstanding borrowings as of that date.

[Table of Contents](#)

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 2017, the capital conservation buffer is 1.25%. As of September 30, 2017, 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%.

The Bank's actual capital amounts and ratios are presented as of September 30, 2017 in the table below.

(Dollars in thousands)	Actual		Minimum Capital for Capital Adequacy Purposes		Minimum Capital for Adequacy with Capital Buffer		Minimum Capital To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to risk weighted assets)	\$ 62,471	13.07%	\$ 38,247	8.00%	\$ 44,223	9.25%	\$ 47,809	10.00%

Tier 1 Capital (to risk weighted assets)	\$ 59,645	12.48%	\$ 28,685	6.00%	\$ 34,661	7.25%	\$ 38,247	8.00%
Common Equity Tier 1 (to risk weighted assets)	\$ 59,645	12.48%	\$ 21,514	4.50%	\$ 27,490	5.75%	\$ 31,076	6.50%
Tier 1 Leverage Capital (to average assets)	\$ 59,645	8.77%	\$ 27,189	4.00%	N/A	N/A	\$ 33,987	6.00%

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) 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.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.

45

[Table of Contents](#)

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 September 30, 2017) that has materially affected, or is reasonably likely to materially affect, such internal controls.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

At September 30, 2017 there were no material legal proceedings to which the Corporation is a party or of which any of its property is subject. From time to time, the Corporation is a party to various legal proceedings incident to its business.

Item 1A - Risk Factors

Not required for smaller reporting companies.

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 September 30, 2017, 101,548 shares remained available to be repurchased.

46

[Table of Contents](#)

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

<u>Exhibit No.</u>	<u>Description</u>
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 September 30, 2017 were formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016, (ii) Consolidated Statements of Net Income for the three and nine months ended September 30, 2017 and 2016, (iii) Consolidated Statements of Comprehensive Income for the nine months ended September 30, 2017 and 2016, (iv) Consolidated Statements of Changes in Stockholders' Equity for the nine months ended September 30, 2017 and (v) Notes to Unaudited Consolidated Financial Statements.

*Filed herewith

47

[Table of Contents](#)

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: November 7, 2017

By: /s/ William A. White
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Jeanette Fritz
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

48

[\(Back To Top\)](#)

Section 2: EX-31.1 (EX-31.1)

Exhibit 31.1

CERTIFICATION

1) I have reviewed this report on Form 10-Q of Coastway Bancorp, Inc.;

- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant of as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial report, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 7, 2017

/s/ William A. White

William A. White
President and Chief Executive Officer

[\(Back To Top\)](#)

Section 3: EX-31.2 (EX-31.2)

Exhibit 31.2

CERTIFICATION

- 1) I have reviewed this report on Form 10-Q of Coastway Bancorp, Inc.;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant of as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our

supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

- b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial report, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to records, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 7, 2017

/s/ Jeanette Fritz

Jeanette Fritz

Executive Vice President and Chief Financial Officer

[\(Back To Top\)](#)

Section 4: EX-32 (EX-32)

Exhibit 32

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Coastway Bancorp, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2017 as filed with the Securities and Exchange Commission (the "Report"), the undersigned, William A. White, President, and Chief Executive Officer of the Company, and Jeanette Fritz, Executive Vice President and Chief Financial Officer, each certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of his/her knowledge:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William A. White

William A. White

President and Chief Executive Officer

Dated: November 7, 2017

/s/ Jeanette Fritz

Jeanette Fritz

Executive Vice President and Chief Financial Officer

Dated: November 7, 2017

Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

[\(Back To Top\)](#)