

Oconee Federal Financial Corp.  
Form 10-K  
September 29, 2014

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the Fiscal Year Ended June 30, 2014

OR

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

For the transition period from            to

Commission File Number: 001-35033

**Oconee Federal Financial Corp.**

(Exact Name of Registrant as Specified in its Charter)

**Federal**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**32-0330122**  
(I.R.S. Employer  
Identification Number)

**201 East North Second Street, Seneca, South Carolina**  
(Address of Principal Executive Offices)

**29678**  
(Zip Code)

**(864) 882-2765**

(Registrant's Telephone Number Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act:

**Title of Each Class**  
Common Stock, par value \$0.01 per share

**Name of Each Exchange on Which Registered**  
The NASDAQ Stock Market, LLC

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

As of September 12, 2014 there were 5,834,395 shares outstanding of the registrant's common stock. The aggregate value of the voting and non-voting common stock held by non-affiliates of the registrant, computed by reference to the closing price of the common stock as of December 31, 2013 was \$25.0 million.

### DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2014 Annual Meeting of Stockholders. (Part III)
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**PART I**

**ITEM 1. *Business***

**Forward Looking Statements**

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

statements of our goals, intentions and expectations;

statements regarding our business plans and prospects and growth and operating strategies;

statements regarding the asset quality of our loan and investment portfolios; and

estimates of our risks and future costs and benefits.

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Annual Report.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

our ability to manage our operations under the current adverse economic conditions (including real estate values, loan demand, inflation, commodity prices and employment levels) nationally and in our market areas;

adverse changes in the financial industry, securities, credit and national and local real estate markets (including real estate values);

significant increases in our delinquencies and loan losses, including as a result of our inability to resolve classified assets, changes in the underlying cash flows of our borrowers, and management's assumptions in determining the adequacy of the allowance for loan losses;

credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and in our allowance and provision for loan losses;

use of estimates for determining the fair value of certain of our assets, which may prove to be incorrect and result in significant declines in valuations;

increased competition among depository and other financial institutions;

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our ability to attract and maintain deposits, including attracting and maintaining deposits and introducing new deposit products;

changes in interest rates generally, including changes in the relative differences between short term and long term interest rates and in deposit interest rates, that may affect our net interest margin and funding sources;

fluctuations in the demand for loans, which may be affected by the number of unsold homes, land and other properties in our market areas and by declines in the value of real estate in our market area;

declines in the yield on our assets resulting from the current low interest rate environment;

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our ability to successfully implement our business strategies, including attracting and maintaining deposits and introducing new financial products;

risks related to high concentration of loans secured by real estate located in our market areas;

changes in the level of government support of housing finance;

the results of examinations by our regulators, including the possibility that our regulators may, among other things, require us to increase our reserve for loan losses, write down assets, change our regulatory capital position, limit our ability to borrow funds or maintain or increase deposits, or prohibit us from paying dividends, which could adversely affect our dividends and earnings;

our ability to enter new markets successfully and capitalize on growth opportunities;

our businesses may not be combined successfully, or such combination may take longer to accomplish than expected;

the growth opportunities and cost savings from the acquisition of Stephens Federal Bank may not be fully realized or may take longer to realize than expected;

our ability to manage increased expenses following the acquisition of Stephens Federal Bank, including salary and employee benefit expenses and occupation expenses;

operating costs, customer losses and business disruption following the acquisition of Stephens Federal Bank, including adverse effects of relationships with employees, may be greater than expected;

our ability to attract and maintain deposits, including former depositors of Stephens Federal Bank;

changes in laws or government regulations or policies affecting financial institutions, including the Dodd-Frank Act and the JOBS Act, which could result in, among other things, increased deposit insurance premiums and assessments, capital requirements (particularly the new capital regulations), regulatory fees and compliance costs and the resources we have available to address such changes;

our reliance on a small executive staff;

changes in our compensation and benefit plans, and our ability to retain key members of our senior management team and to address staffing needs to implement our strategic plan;

changes in consumer spending, borrowing and savings habits;

changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;

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our ability to control costs and expenses, particularly those related to operating as a publicly traded company;

other changes in our financial condition or results of operations that reduce capital available to pay dividends;

other changes in the financial condition or future prospects of issuers of securities that we own, including our stock in the FHLB of Atlanta; and

other economic, competitive, governmental, regulatory and operational factors affecting our operations, pricing, products and services.

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Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

#### **Oconee Federal Financial Corp.**

Oconee Federal Financial Corp. (the "Company") is a federally-chartered corporation that was incorporated in January 2011 to be the mid-tier stock holding company for Oconee Federal Savings and Loan Association in connection with the mutual-to-stock conversion of Oconee Federal Savings and Loan Association. As of June 30, 2014, Oconee Federal Financial Corp. had 5,834,395 shares outstanding and a market capitalization of approximately \$105.4 million.

The executive offices of Oconee Federal Financial Corp. are located at 201 East North Second Street, Seneca, South Carolina 29678, and the telephone number is (864) 882-2765. Our website address is [www.oconeefederal.com](http://www.oconeefederal.com). Information on our website should not be considered a part of this annual report. Oconee Federal Financial Corp. is subject to comprehensive regulation and examination by the Board of Governors of the Federal Reserve System.

At June 30, 2014, we had total assets of \$360.5 million, total deposits of \$281.0 million and total equity of \$77.0 million. We recorded net income of \$3.6 million for the year ended June 30, 2014.

#### **Oconee Federal Savings and Loan Association**

Oconee Federal Savings and Loan Association is a federally chartered savings and loan association headquartered in Seneca, South Carolina. Oconee Federal Savings and Loan Association was originally chartered by the State of South Carolina in 1924 as Seneca Building and Loan Association. In 1958, it changed its name to "Oconee Savings and Loan Association," and in 1991 it converted to a federal charter under the name "Oconee Federal Savings and Loan Association."

Our principal business consists of attracting retail deposits from the general public in our market area and investing those deposits, together with funds generated from operations, in one-to-four family residential mortgage loans and, to a much lesser extent, non-residential mortgage, construction and land and other loans. We also invest in U.S. Government and federal agency securities, mortgage-backed securities and short-term deposits. We have also used borrowed funds as a source of funds, and we borrow principally from the Federal Home Loan Bank of Atlanta. We conduct our business from our main office, our executive office annex and three branch offices. All of our offices are located in Oconee County, South Carolina. Our primary market area consists of Oconee County and the nearby communities and townships in adjacent counties in South Carolina.

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

#### **Oconee Federal, MHC**

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



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**Market Area**

We conduct business through our main office, our executive office annex and one branch office located in Seneca, South Carolina and one additional branch office located in each of Walhalla, South Carolina and Westminster, South Carolina. All five of our offices are located in Oconee County, which is located on the I-85 corridor between the Charlotte and Atlanta metropolitan areas, approximately 120 miles south of Charlotte and approximately 120 miles north of Atlanta. Our offices are also located approximately 40 miles south of Greenville, South Carolina, and 10 miles from Clemson, South Carolina.

Our primary market area, which consists of Oconee County and the nearby communities and townships in adjacent counties in South Carolina, is mostly rural and suburban in nature. The Oconee County economy has historically been concentrated in manufacturing. Plant closings and layoffs in this sector, particularly in light manufacturing industries, in recent years have contributed to high unemployment in Oconee County. The regional economy is fairly diversified, with services, wholesale/retail trade, manufacturing and government providing the primary support. In addition, Oconee County and nearby counties are experiencing an increase in retiree populations. Oconee County's and South Carolina's respective June 2014 unemployment rates of 6.2% and 5.3% compare favorably to the national unemployment rate of 6.1% for June 2014.

The largest employers in Oconee County are education and health services providers, public utilities and light manufacturing companies, including the Oconee County and Seneca City School Systems, Oconee Medical Center, Duke Energy, an electric utility and provider of nuclear and hydroelectric energy, Schneider Electric-Square D, a manufacturer of electronic components, Itron, a manufacturer of electronic measuring devices and Covidien, a manufacturer of healthcare products. Other employers include the local government, retail trade and the leisure/hospitality industry. Many residents of Oconee County are employed in nearby Greenville, South Carolina, which has major employers such as BMW Motors, Inc. and Greenville Health System, and in Pickens County, which has major employers such as Clemson University and the Pickens County school system. In addition, although we only accept deposits from existing customers and residents of Oconee County, we extend credit to residents of counties adjacent to Oconee County in order to take advantage of the additional lending market located in these areas.

**Competition**

Competition for making loans and attracting deposits in our primary market area is intense, particularly in light of the relatively modest population base of Oconee County and the relatively large number of institutions that maintain a presence in the county. Financial institution competitors in our primary market area include other locally-based commercial banks, thrifts and credit unions, as well as regional and super-regional banks. We also compete with depository and lending institutions not physically located in our primary market area but capable of doing business remotely, mortgage loan originators and mortgage brokers and other companies in the financial services industry, such as investment firms, mutual funds and insurance companies. Some of our competitors offer products and services that we currently do not offer, such as trust services and private banking. To meet our competition, we seek to emphasize our community orientation, local and timely decision making and superior customer service. As of June 30, 2013 the most recent date of available data, our market share of deposits represented 26.14% of FDIC-insured deposits in Oconee County.

**Lending Activities**

The principal lending activity of Oconee Federal Savings and Loan Association is originating one-to-four family residential mortgage loans and, to a much lesser extent, home equity loans, non-residential mortgage loans, construction and land loans, and other loans. In recent years we have

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modestly expanded our non-residential mortgage loans in an effort to diversify our overall loan portfolio, increase the yield of our loans and shorten asset duration. In addition, we may modestly increase our home equity loan portfolio.

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

	At June 30,					
	2014		2013		2012	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
<b>Real estate loans:</b>						
One-to-four family(1)	\$ 214,735	92.55%	\$ 204,397	91.61%	\$ 234,125	92.82%
Multi-family	254	0.11	258	0.12	264	0.10
Home equity	227	0.10	292	0.13	395	0.16
Nonresidential	8,408	3.62	8,521	3.82	9,226	3.66
Construction and land	7,661	3.30	8,735	3.91	7,232	2.87
<b>Total real estate loans</b>	<b>231,285</b>	<b>99.68</b>	<b>222,203</b>	<b>99.59</b>	<b>251,242</b>	<b>99.61</b>
Consumer and other loans	747	0.32	925	0.41	987	0.39
<b>Total loans</b>	<b>\$ 232,032</b>	<b>100.00%</b>	<b>\$ 223,128</b>	<b>100.00%</b>	<b>\$ 252,229</b>	<b>100.00%</b>
Net deferred loan fees	(1,246)		(1,214)		(1,540)	
Allowance for loan losses	(855)		(751)		(857)	
<b>Loans, net</b>	<b>\$ 229,931</b>		<b>\$ 221,163</b>		<b>\$ 249,832</b>	

	At June 30,			
	2011		2010	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
<b>Real estate loans:</b>				
One-to-four family	\$ 249,064	93.16%	\$ 250,390	93.81%
Multi-family	269	0.10	380	0.14
Home equity	466	0.17	510	0.19
Nonresidential	9,399	3.52	9,456	3.54
Construction and land	7,156	2.68	5,158	1.94
<b>Total real estate loans</b>	<b>266,354</b>	<b>99.63</b>	<b>265,894</b>	<b>99.62</b>
Consumer and other loans	985	0.37	1,012	0.38

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Total loans	\$ 267,339	100.00%	\$ 266,906	100.00%
Net deferred loan fees	(1,677)		(1,690)	
Allowance for loan losses	(749)		(888)	
Loans, net	\$ 264,913		\$ 264,328	

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(1) Includes \$1.8 million and \$2.0 million of loans secured by modular and manufactured homes as of June 30, 2014 and June 30, 2013, respectively.

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**Contractual Maturities and Interest Rate Sensitivity.** The following table summarizes the scheduled repayments of our loan portfolio at June 30, 2014. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less. Loans are presented net of loans in process.

	One- to Four- Family	Multi- family	Home Equity	Non- residential	Construction and Land	Consumer and Other	Total
(Dollars in thousands)							
Amounts due in:							
One year or less	\$ 116	\$	\$ 1	\$ 16	\$	\$ 504	\$ 637
More than one to two years	144		1	23		239	407
More than two to three years	630				13	4	647
More than three to five years	4,681		181	51	202		5,115
More than five to ten years	14,463		44	78	2,374		16,959
More than ten to fifteen years	22,387			5,920	64		28,371
More than fifteen years	172,314	254		2,320	5,008		179,896
<b>Total</b>	<b>\$ 214,735</b>	<b>\$ 254</b>	<b>\$ 227</b>	<b>\$ 8,408</b>	<b>\$ 7,661</b>	<b>\$ 747</b>	<b>\$ 232,032</b>

The following table summarizes our fixed-rate and adjustable-rate loans that are due after June 30, 2015.

Interest rate terms on amounts due after one year:							
Fixed-rate loans	\$ 200,115	\$	\$ 226	\$ 8,392	\$ 7,661	\$ 243	\$ 216,637
Adjustable-rate loans	14,504	254					14,758
<b>Total</b>	<b>\$ 214,619</b>	<b>\$ 254</b>	<b>\$ 226</b>	<b>\$ 8,392</b>	<b>\$ 7,661</b>	<b>\$ 243</b>	<b>\$ 231,395</b>

**Loan Approval Procedures and Authority.** Pursuant to federal law, the aggregate amount of loans that Oconee Federal Savings and Loan Association is permitted to make to any one borrower or a group of related borrowers is generally limited to 15% of Oconee Federal Savings and Loan Association's unimpaired capital and surplus (25% if the amount in excess of 15% is secured by "readily marketable collateral" or 30% for certain residential development loans). At June 30, 2014, based on the 15% limitation, Oconee Federal Savings and Loan Association's loans-to-one-borrower limit was approximately \$11.5 million. On the same date, Oconee Federal Savings and Loan Association had no borrowers with outstanding balances in excess of this amount. At June 30, 2014, our largest loan relationship with one borrower was for approximately \$3.1 million secured by a church building located in Seneca, South Carolina, and was performing in accordance with its terms on that date.

Our lending is subject to written underwriting standards and origination procedures. Decisions on loan applications are made on the basis of detailed applications submitted by the prospective borrower, credit histories that we obtain, and property valuations (consistent with our appraisal policy) prepared by outside independent licensed appraisers approved by our board of directors as well as internal evaluations, where permitted by regulations. The loan applications are designed primarily to determine the borrower's ability to repay the requested loan, and the more significant items on the application are verified through use of credit reports, financial statements and tax returns.

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Under our loan policy, the loan officer processing an application is responsible for ensuring proposals and approval of any extensions of credit are in compliance with internal policies and procedures and applicable laws and regulations, and for establishing and maintaining credit files and documentation sufficient to support the loan and to perfect any collateral position. The Loan

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Committee of the board of directors reviews all loan applications, and may override the risk analysis of loan officers.

Our lending officers do not have individual lending authority. The Loan Committee has approval authority for loans up to \$250 thousand. Real estate loans over \$250 thousand must be approved by the Loan Committee and ratified by the board of directors. Our board of directors must approve all loans in excess of \$500 thousand. To ensure adequate liquidity, under our loan policy, aggregate loans outstanding should not exceed our total deposits and advances from the Federal Home Loan Bank of Atlanta.

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

***One-to-four Family Residential Real Estate Lending.*** The cornerstone of our lending program has long been the origination of long-term loans secured by mortgages on owner-occupied one-to-four family residences. At June 30, 2014, \$214.7 million, or 92.6% of our total loan portfolio, consisted of one-to-four family residential mortgage loans. At that date, our average outstanding one-to-four family residential mortgage loan balance was \$116 thousand and our largest outstanding residential loan had a principal balance of \$1.5 million. At June 30, 2014, our ten largest loans in our portfolio totaled \$14.8 million, of which five loans totaling \$5.8 million were one-to-four residential mortgages and three loans totaling \$4.7 million were one-to-four residential construction mortgages. Virtually all of the residential mortgage loans we originate are secured by properties located in our market area.

The terms of our mortgage loans are generally up to 30 years for traditional homes and up to 15 years for manufactured or modular homes. The terms of non-owner-occupied homes are generally up to 15 years for fixed-rate loans and up to 30 years for adjustable-rate loans. Due to consumer demand in the current low market interest rate environment, many of our recent originations are 15- to 30-year fixed-rate loans secured by one-to-four family residential real estate. Although we typically retain in our portfolio the loans we originate, we generally originate our fixed-rate one-to-four family residential loans in accordance with secondary market standards. At June 30, 2014, we had in our portfolio \$20.0 million of residential mortgage loans with original contractual maturities of 10 years or less, \$22.4 million of residential mortgage loans with original contractual maturities between 10 and 15 years and \$172.3 million of residential mortgage loans with original contractual maturities in excess of 15 years.

In order to reduce the term to repricing of our loan portfolio, we also originate one-year adjustable-rate one-to-four family residential mortgage loans. Our current adjustable-rate mortgage loans have fixed rates for the first 12 months, and then carry interest rates that adjust annually at a rate based on the change, between closing of the loan and the adjustment date, of the Federal Home Loan Bank Board's published contract interest rate, which represents the national average rate for purchases of previously occupied homes. Such loans carry terms to maturity of up to 30 years. The adjustable-rate mortgage loans currently offered by us generally provide for a 100 basis point annual interest rate change cap, a lifetime cap of 500 basis points over the initial rate and a lifetime floor of 200 basis points under the initial rate.

Although adjustable-rate mortgage loans may reduce to an extent our vulnerability to changes in market interest rates because they periodically reprice, as interest rates increase, the required payments due from the borrower also increase (subject to rate caps), increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustments of the contractual interest rate are also limited by the maximum periodic and lifetime rate adjustments permitted by our loan documents. At June 30, 2014, \$14.5 million, or 6.8% of our one-to-four family residential loans, had adjustable rates of interest.

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During the year ended June 30, 2014, we originated 7 one-to-four family residential loans totaling \$1.2 million with adjustable rates of interest.

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

We currently originate residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes. For traditional homes, we may originate loans with loan-to-value ratios in excess of 80% if the borrower obtains mortgage insurance or provides readily marketable collateral. We may make exceptions for special loan programs that we offer. For example, we currently offer mortgages of up to \$95 thousand with loan-to-value ratios of up to 95% to low- to moderate-income borrowers solely for the purchase of their primary residence. We also originate residential mortgage loans for non-owner-occupied homes with loan-to-value ratios of up to 75%.

We also originate residential mortgage loans with loan-to-value ratios of up to 75% for manufactured or modular homes. We require lower loan-to-value ratios for manufactured and modular homes because such homes tend to depreciate over time. Manufactured or modular homes must be permanently affixed to a lot to make them more difficult to move without our permission. Such homes must be "de-titled" by the State of South Carolina so that they are taxed and must be transferred as residential homes rather than vehicles. We also obtain a mortgage on the real estate to which such homes are affixed. At June 30, 2014, the balance of loans secured by manufactured or modular homes was \$1.8 million, representing 0.83% of our one-to-four family residential loans and 0.77% of our total loans.

At June 30, 2014, we had \$1.9 million of one-to-four family residential mortgage loans that were 60 days or more delinquent and \$4.9 million of one-to four-family residential mortgage loans that were 30-59 days delinquent. Among delinquent loans past due more than 60 days, only one loan exceeded \$250 thousand in outstanding principal, or 41.5%, of total loans in this category. For loans past due 30-59 days past due, three loans with outstanding balances greater than \$300 thousand totaled \$1.1 million, or 22.7%, of the total balance of loans in this category.

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

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

**Non-Residential Real Estate Lending.** Our non-residential real estate loans are secured primarily by churches and, to a much lesser extent, office buildings, and retail and mixed-use properties located in our primary market area. We believe that focusing on loans to churches enables us to maintain our

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status as a community-oriented institution, and build our customer base as congregation members become familiar with us. At June 30, 2014, we had \$8.4 million in non-residential real estate loans, representing 3.6% of our total loan portfolio.

The non-residential real estate loans that we originate generally have maximum terms of 5 years with amortization periods of 30 years. For loans secured by church property, our loans generally have maximum terms of 20 years with amortization periods of up to 20 years. The maximum loan-to-value ratio of our non-residential real estate loans is generally 75%. At June 30, 2014, our average outstanding non-residential mortgage loan balance was \$311 thousand. Our largest non-residential real estate relationship totaled \$3.1 million, of which \$2.9 million related to one loan. This loan is secured by a mortgage on a church building in Seneca, South Carolina, and, at June 30, 2014, this loan was performing in accordance with its terms. At June 30, 2014, of our ten largest loans in our total portfolio, two loans totaling \$4.3 million were non-residential real estate loans.

Set forth below is information regarding our non-residential real estate loans at June 30, 2014.

Type of Loan	Number of Loans	Balance (Dollars in thousands)
Church	21	\$ 8,306
Other non-residential	5	102
Total	26	\$ 8,408

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

Loans secured by non-residential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Non-residential real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. In addition, because a church's financial stability often depends on donations from congregation members, some of whom may not reside in our market area, rather than income from business operations, repayment may be affected by economic conditions that affect individuals located both in our market area and in other market areas with which we are not as familiar. In addition, due to the unique nature of church buildings and properties, the real estate securing church loans may be less marketable than other non-residential real estate. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate. At June 30, 2014, all of our non-residential real estate loans were performing in accordance with their terms.



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**Construction Lending.** We make construction loans to individuals for the construction of their primary residences. These loans generally have maximum terms of eight months, and upon completion of construction convert to conventional amortizing mortgage loans. These construction loans have rates and terms comparable to one-to-four family residential mortgage loans that we originate. During the construction phase, the borrower generally pays interest only. The maximum loan-to-value ratio of our owner-occupied construction loans is 80%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential mortgage loans.

We also make interim construction loans for non-residential properties. In addition, we occasionally make loans for the construction of homes "on speculation," but we generally permit a borrower to have only one such loan at a time. These loans generally have a maximum term of eight months, and upon completion of construction convert to conventional amortizing non-residential real estate loans. These construction loans have rates and terms comparable to permanent loans secured by property of the type being constructed that we originate. The maximum loan-to-value ratio of these construction loans is 80%.

We make loans secured by land to complement our construction lending activities. These loans have terms of up to 10 years, and maximum loan-to-value ratios of 75% for improved lots and 65% for unimproved land.

	Number of Loans		Loans in Process		Principal Balance
	(Dollars in thousands)				
One-to-four family	37	\$	10,557	\$	5,024
Nonresidential	1	\$	102	\$	48
Land	41				2,589
 Total construction and land loans	 79	 \$	 10,659	 \$	 7,661

At June 30, 2014, our largest residential construction loan was for \$1.6 million, of which \$0 was outstanding. This loan was performing according to its terms at June 30, 2014. At June 30, 2014, all of our construction loans were performing in accordance with their terms.

The application process for a construction loan includes a submission to Oconee Federal Savings and Loan Association of accurate plans, specifications and costs of the project to be constructed or developed, a copy of the deed or plat survey of the real estate involved in the loan and an appraisal of the proposed collateral for the loan. Our construction loan agreements generally provide that loan proceeds are disbursed in increments as construction progresses. Outside independent licensed or certified appraisers inspect the progress of the construction of the dwelling before disbursements are made.

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

**Home Equity Lending.** We originate fixed-rate home equity loans secured by a lien on the borrower's primary residence, but only where we hold the first mortgage on the property. Our home

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equity loans are limited to an 80% loan-to-value ratio (including all prior liens), and have terms of up to 10 years with 10-year amortization periods. We use the same underwriting standards for home equity loans as we use for one-to-four family residential mortgage loans. Although we do not currently offer home equity lines of credit, we may offer lines of credit in the future. We expect that any lines of credit that we issue will be originated and underwritten using the same standards that we use for home equity loans and residential mortgage loans. At June 30, 2014, we had \$227 thousand of home equity loans outstanding, representing 0.10% of our total loan portfolio.

**Consumer Lending.** We offer installment loans for various consumer purposes, including the purchase of automobiles, boats, appliances and recreational vehicles, and for other legitimate personal purposes. The maximum terms of consumer loans is 18 months for unsecured loans, 12 months for loans secured by marketable securities and 18-60 months for loans secured by a vehicle, depending on the age of the vehicle.

To date, our consumer lending apart from home equity loans has been quite limited. We generally only extend consumer loans to existing customers or their immediate family members, and these loans generally have relatively low limits. At June 30, 2014, we had \$747 thousand of consumer loans outstanding, representing 0.32% of our total loan portfolio. Of these loans, \$719 thousand, or 96.3%, were secured by deposits at Oconee Federal Savings and Loan Association.

Consumer loans may entail greater credit risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At June 30, 2014, all of our consumer loans were performing in accordance with their terms.

**Originations, Purchases and Sales of Loans**

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

We currently do not purchase whole loans or interests in loans from third parties or sell any of the loans that we originate into the secondary market. However, we may in the future elect to do so, depending on market conditions, in order to supplement our loan production or diversify our risk.

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

	<b>Years Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(In thousands)</b>	
Total loans at beginning of period	\$ 223,128	\$ 252,229
<b>Loans originated:</b>		
Real estate loans:		
One-to-four family	29,949	16,632
Multi-family		
Home equity		
Nonresidential	248	62
Construction and land	5,287	18,576
Total real estate loans	35,484	35,270
Consumer and other loans	353	170
Total loans originated	35,837	35,440
<b>Deduct:</b>		
Principal repayments	(26,865)	(63,154)
Transfers to real estate owned	(68)	(1,387)
Net loan activity	8,904	(29,101)
Total loans at end of period	\$ 232,032	\$ 223,128

### **Delinquencies and Non-Performing Assets**

**Delinquency Procedures.** When a loan payment becomes 20 days past due, we contact the customer by mailing a late notice. If a loan payment becomes 30 days past due, we mail a "right to cure" letter to the borrower and any co-makers and endorsers. If a loan payment becomes 90 days past due (or a borrower misses three consecutive payments, whichever occurs first), we send a demand letter and generally cease accruing interest. It is our policy to institute legal procedures for collection or foreclosure when a loan becomes 120 days past due, unless management determines that it is in the best interest of Oconee Federal Savings and Loan Association to work further with the borrower to arrange a workout plan. It is our policy to not accept deeds in lieu of foreclosure.

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

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**Delinquent Loans.** The following table sets forth our loan delinquencies, including non-accrual loans, by type and amount at the dates indicated.

	At June 30,							
	2014			2013				
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due
	(Dollars in thousands)							
Real estate loans:								
One-to-four family	\$ 4,856	\$ 893	\$ 1,053	\$ 6,802	\$ 5,932	\$ 2,397	\$ 1,726	\$ 10,055
Multi-family								
Home equity					30			30
Nonresidential	87			87				
Construction and land								
<b>Total real estate loans</b>	<b>4,943</b>	<b>893</b>	<b>1,053</b>	<b>6,889</b>	<b>5,962</b>	<b>2,397</b>	<b>1,726</b>	<b>10,085</b>
Consumer and other loans					1			1
<b>Total</b>	<b>\$ 4,943</b>	<b>\$ 893</b>	<b>\$ 1,053</b>	<b>\$ 6,889</b>	<b>\$ 5,963</b>	<b>\$ 2,397</b>	<b>\$ 1,726</b>	<b>\$ 10,086</b>

Total delinquencies declined \$3.2 million, or 31.7%, to \$6.9 million at June 30, 2014 as compared with total delinquencies of \$10.1 million at June 30, 2013. The decline in our delinquencies is a reflection of improving asset quality and a stronger economy in our market area during 2014 as compared with 2013. We count loans with partial payments due as delinquent.

**Classified Assets.** Federal regulations provide for the classification of loans and other assets, such as debt and equity securities considered to be of lesser quality, as "substandard," "doubtful" or "loss." An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard," with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable." Assets classified as "loss" are those considered "uncollectible" and of such little value that their continuance as assets without the establishment of a specific loss allowance is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated as "special mention" by our management.

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

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

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

	At June 30,	
	2014	2013
	(Dollars in thousands)	
Special mention assets	\$	\$
Substandard assets	1,647	1,986
Doubtful assets(1)	744	1,047
Loss assets		
Total classified assets	\$ 2,391	\$ 3,033

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(1) Consists solely of real estate owned.

Doubtful assets or real estate owned assets decreased by \$303, thousand, or 28.9%, to \$744 thousand at June 30, 2014 from \$1.0 million at June 30, 2013. Our substandard assets decreased by \$339 thousand, or 17.1%, to \$1.6 million at June 30, 2014 from \$2.0 million at June 30, 2013, and our overall classified asset totals decreased by \$642 thousand, or 21.2%, to \$2.4 million at June 30, 2014 from \$3.0 million at June 30, 2013 due to improving credit quality in our loan portfolio.

**Non-Performing Assets.** We generally cease accruing interest on our loans when contractual payments of principal or interest have become 90 days delinquent unless the loan is well-secured and in the process of collection. Loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not received for loans placed on non-accrual are reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until the loans qualify for return to accrual. Generally, loans are restored to accrual status when all the principal and interest amounts contractually due are brought current, and future payments are reasonably assured. Loans are moved to non-accrual status in accordance with our policy, which is typically after 90 days of non-payment.

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The table below sets forth the amounts and categories of our non-performing assets at the dates indicated.

	At June 30,				
	2014	2013	2012	2011	2010
	(Dollars in thousands)				
Non-accrual loans:					
Real estate loans:					
One- to four-family	\$ 1,647	\$ 1,493	\$ 2,157	\$ 1,567	\$ 3,214
Multi-family					
Home equity					
Non-residential					
Construction and land					
Total real estate loans	1,647	1,493	2,157	1,567	3,214
Consumer and other loans					
Total nonaccrual loans	\$ 1,647	\$ 1,493	\$ 2,157	\$ 1,567	\$ 3,214
Accruing loans past due 90 days or more:					
Real estate loans:					
One- to four-family	\$	\$ 493	\$ 145	\$	\$ 764
Multi-family					
Home equity					
Non-residential					
Construction and land					
Total real estate loans		493	145		764
Consumer and other loans					
Total accruing loans past due 90 days or more		493	145		764
Total of nonaccrual and 90 days or more past due loans	\$ 1,647	\$ 1,986	\$ 2,302	\$ 1,567	\$ 3,978
Real estate owned:					
One- to four-family	\$ 744	\$ 1,047	\$ 854	\$ 2,254	\$ 751
Multi-family					
Home equity					
Non-residential					
Other					
Other nonperforming assets					
Total nonperforming assets	\$ 2,391	\$ 3,033	\$ 3,156	\$ 3,821	\$ 4,729

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Troubled debt restructurings

Troubled debt restructurings and total nonperforming assets	\$	2,391	\$	3,033	\$	3,156	\$	3,821	\$	4,729
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Total nonperforming loans to total loans	0.71%	0.89%	0.91%	0.59%	1.49%
Total nonperforming assets to total assets	0.66%	0.82%	0.84%	1.02%	1.42%
Total nonperforming assets to loans and real estate owned	1.03%	1.35%	1.25%	1.42%	1.77%

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

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Interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$63 thousand for the year ended June 30, 2014. Interest of \$17 thousand was recognized on these loans and is included in net income for the year ended June 30, 2014.

**Allowance for Loan Losses**

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

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

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

the strength of the customer's personal or business cash flows;

the availability of other sources of repayment;

the amount due or past due;

the type and value of collateral;

the strength of our collateral position;

the estimated cost to sell the collateral; and

the borrower's effort to cure the delinquency.

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

***General Valuation Allowance on Certain Identified Problem Loans.*** Although our policy allows for a general valuation allowance on certain smaller balance, homogenous pools of loans classified as substandard, we have historically evaluated non-performing loans, regardless of size, for impairment in establishing a specific allowance.

***General Valuation Allowance on the Remainder of the Loan Portfolio.*** We establish a general allowance for loans that are not otherwise specifically identified as impaired to recognize the probable incurred losses within our portfolio, but which, unlike specific allowances, has not been allocated to particular problem loans. In estimating this portion of the allowance, we apply loss factors to each category of loan. We estimate our loss factors taking into consideration both quantitative and qualitative aspects that would affect our estimation of probable incurred losses. These aspects include, but are not limited to historical charge-offs; loan delinquencies and foreclosure trends; current economic trends and demographic data within Oconee County and the surrounding areas, such as unemployment rates and population trends; current trends in real estate values within the Oconee County market area; charge-off trends of other comparable institutions; the results of any internal loan reviews; loan to value ratios; our historically conservative credit risk policy; the strength of our underwriting and ongoing credit monitoring function; and other relevant factors.





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

Our allowance for loan losses increased to \$855 thousand at June 30, 2014 from \$751 thousand at June 30, 2013. The increase reflected a slight increase in the allowance for individually impaired loans to \$52 thousand at June 30, 2014 as compared with \$27 thousand at June 30, 2013, and the increase also reflected an increase in our general valuation allowance due to the growth in our total loan portfolio. Our total gross loan portfolio increased \$8.9 million to \$232.0 million at June 30, 2014 as compared with \$223.1 million at June 30, 2013. All nonperforming loans are classified as substandard and are considered to be impaired. Our total of impaired loans decreased to \$1.6 million at June 30, 2014 from \$2.0 million at June 30, 2013. However, the specific portion of our allowance attributable to these impaired loans increased slightly to \$52 thousand from \$27 thousand for the same periods ended due to slightly higher quality of underlying real estate collateral used to measure the amount of impairment in the prior year as compared with the current year. Net charge offs for the year ended June 30, 2014 were \$4 thousand compared with \$366 thousand for the year ended June 30, 2013. Our net charge offs in 2013 were primarily impacted by one large one-to-four family residential real estate loan charge off of \$277 thousand during the third quarter of 2013, which was not reflective of our overall asset quality of our remaining portfolio of one-to-four family real estate loans. Our allowance for loan losses at June 30, 2014 and 2013 represented 0.37% and 0.34%, respectively, of total gross loans. Our allowance for loan losses to nonperforming loans was 51.9% at June 30, 2014 and 37.8% at June 30, 2013.

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

	Year Ended June 30,				
	2014	2013	2012	2011	2010
	(Dollars in thousands)				
Allowance at beginning of period	\$ 751	\$ 857	\$ 749	\$ 888	\$ 258
Provision for loan losses	108	260	270	135	758
Charge offs:					
Real estate loans					
One- to four-family	(4)	(366)	(145)	(268)	(128)
Multi-family					
Home equity					
Non-residential					
Construction and land			(17)		
Consumer and other loans				(6)	
<b>Total charge-offs</b>	<b>(4)</b>	<b>(366)</b>	<b>(162)</b>	<b>(274)</b>	<b>(128)</b>
Recoveries:					
Real estate loans					
One- to four-family					
Multi-family					
Home equity					
Non-residential					
Construction and land					
Consumer and other loans					
<b>Total recoveries</b>					
<b>Net charge-offs</b>	<b>(4)</b>	<b>(366)</b>	<b>(162)</b>	<b>(274)</b>	<b>(128)</b>
Allowance at end of period	\$ 855	\$ 751	\$ 857	\$ 749	\$ 888
Allowance to nonperforming loans	51.91%	37.81%	37.23%	47.80%	22.32%
Allowance to total loans outstanding at the end of the period	0.37	0.34	0.34	0.28	0.33
Net charge-offs to average loans outstanding during the period	0.00	0.16	0.06	0.10	0.05

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**Allocation of Allowance for Loan Losses.** The following table sets forth the allowance for loan losses allocated by loan category, the total loan balances by category, and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

(Dollars in thousands)	At June 30,								
	2014			2013			2012		
	Amount	% of Allowance to Total	% of Loans in Category to Total	Amount	% of Allowance to Total	% of Loans in Category to Total	Amount	% of Allowance to Total	% of Loans in Category to Total
Real estate loans:									
One- to four-family	\$ 736	86.08%	92.55%	\$ 665	88.55%	92.55%	\$ 773	90.20%	92.82%
Multi-family	4	0.47	0.11	4	0.53	0.11	4	0.47	0.10
Home equity	1	0.12	0.10	1	0.13	0.10	1	0.12	0.16
Non-residential	52	6.08	3.62	52	6.92	3.64	56	6.53	3.66
Construction and land	59	6.90	3.30	27	3.60	3.28	21	2.45	2.87
<b>Total real estate loans</b>	<b>852</b>	<b>99.65</b>	<b>99.68</b>	<b>749</b>	<b>99.73</b>	<b>99.68</b>	<b>855</b>	<b>99.77</b>	<b>99.61</b>
Consumer and other loans	3	0.35	0.32	2	0.27	0.32	2	0.23	0.39
<b>Total allowance for loan losses</b>	<b>\$ 855</b>	<b>100.00%</b>	<b>100.00%</b>	<b>\$ 751</b>	<b>100.00%</b>	<b>100%</b>	<b>\$ 857</b>	<b>100.00%</b>	<b>100.00%</b>

(Dollars in thousands)	At June 30,					
	2011			2010		
	Amount	% of Allowance to Total	% of Loans in Category to Total	Amount	% of Allowance to Total	% of Loans in Category to Total
Real estate loans:						
One- to four-family	\$ 646	86.25%	93.16%	\$ 785	88.40%	93.81%
Multi-family	4	0.53	0.10	6	0.68	0.14
Home equity	1	0.13	0.17	1	0.11	0.19
Non-residential	57	7.61	3.52	57	6.42	3.54
Construction and land	38	5.08	2.68	35	3.94	1.93
<b>Total real estate loans</b>	<b>746</b>	<b>99.60</b>	<b>99.63</b>	<b>884</b>	<b>99.55</b>	<b>99.61</b>
Consumer and other loans	3	0.40	0.37	4	0.45	0.39
<b>Total allowance for loan losses</b>	<b>\$ 749</b>	<b>100.00%</b>	<b>100.00%</b>	<b>\$ 888</b>	<b>100.00%</b>	<b>100.00%</b>

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

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**Investment Activities**

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

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

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

At June 30, 2014, we did not have an investment in the securities of any single non-government issuer that exceeded 10% of equity at that date.

Our current investment policy does not permit investment in stripped mortgage-backed securities, complex securities and derivatives as defined in federal banking regulations and other high-risk securities. As of June 30, 2014, we held no asset-backed securities other than mortgage-backed securities. Our current policies do not permit hedging activities, such as engaging in futures, options or swap transactions, or investing in high-risk mortgage derivatives, such as collateralized mortgage obligation residual interests, real estate mortgage investment conduit residual interests or stripped mortgage backed securities. At June 30, 2014, none of the collateral underlying our securities portfolio was considered subprime or Alt-A.

Current accounting principles require that, at the time of purchase, we designate a security as either held-to-maturity, available-for-sale, or trading, based upon our ability and intent. Securities available-for-sale and trading securities are reported at fair value and securities held-to-maturity are reported at amortized cost. A periodic review and evaluation of our available-for-sale and held-to-maturity securities portfolios is conducted to determine if the fair value of any security has declined below its carrying value and whether such decline is other-than-temporary. If such decline is deemed to be other-than-temporary, the security is written down to a new cost basis and the resulting loss is charged against earnings. At June 30, 2014, the fair values of our securities are based on published or securities dealers' market values. At June 30, 2014, the amortized cost of our securities classified as available-for-sale and held-to-maturity was \$104.0 million and \$0, respectively, compared with \$88.9 million and \$8.0 million, respectively, at June 30, 2013. The fair value of the securities classified as available-for-sale was \$103.8 million, and the fair value of the securities classified as held-to-maturity was \$0 compared with \$88.0 million and \$8.2 million, respectively, at June 30, 2013. The increase in securities classified as available-for-sale is a result of moderate loan demand, resulting in excess cash liquidity. During 2014, all securities classified as held-to-maturity were transferred to available-for-sale.

**U.S. Government and Federal Agency Obligations.** We may invest in U.S. Government and federal agency securities. While these securities generally provide lower yields than other investments in our securities investment portfolio, we maintain these investments, to the extent appropriate, for liquidity purposes, as collateral for borrowings and for prepayment protection.

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**Mortgage-Backed Securities.** At June 30, 2014, the amortized cost and fair value of our mortgage-backed securities portfolio totaled \$60.7 million and \$60.4 million, respectively. Mortgage-backed securities are securities issued in the secondary market that are collateralized by pools of mortgages. Certain types of mortgage-backed securities are commonly referred to as "pass-through" certificates because the principal and interest of the underlying loans is "passed through" to investors, net of certain costs, including servicing and guarantee fees. Mortgage-backed securities typically are collateralized by pools of one-to-four family or multifamily mortgages, although we invest primarily in mortgage-backed securities backed by one-to-four family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as the Company. The interest rate of the security is lower than the interest rates of the underlying loans to allow for payment of servicing and guaranty fees. Ginnie Mae, a United States Government agency, and government sponsored enterprises, such as Fannie Mae and Freddie Mac, either guarantee the payments or guarantee the timely payment of principal and interest to investors. Mortgage-backed securities are more liquid than individual mortgage loans since there is an active trading market for such securities. In addition, mortgage-backed securities may be used to collateralize our borrowings.

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

All of our mortgage-backed securities are issued by government agencies or government-sponsored entities.

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

**Bank-Owned Life Insurance.** We invest in bank-owned life insurance to provide us with a funding source for deferred compensation agreements. Bank-owned life insurance also generally provides us non-interest income that is non-taxable. Federal regulations generally limit our investment in bank-owned life insurance to 25% of our Tier 1 capital plus our allowance for loan losses. At June 30, 2014 and 2013, we had \$8.8 and \$8.5 million, respectively, invested in bank-owned life insurance.

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

	At June 30,					
	2014		2013		2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(Dollars in thousands)						
<b>Securities available-for-sale:</b>						
FHLMC common stock	\$ 20	\$ 314	\$ 20	\$ 110	\$ 20	\$ 20
Preferred stock	271	298	271	297	272	272
Certificates of deposit	7,221	7,237				
Municipal securities	5,846	5,809				
U.S. Government agency mortgage-backed securities	60,742	60,440	50,209	49,527	31,205	31,658
U.S. government agencies	29,946	29,708	38,387	38,051	32,081	32,590
<b>Total available-for-sale</b>	<b>\$ 104,046</b>	<b>\$ 103,806</b>	<b>\$ 88,887</b>	<b>\$ 87,985</b>	<b>\$ 63,578</b>	<b>\$ 64,540</b>
<b>Securities held-to-maturity:</b>						
Certificates of deposit	\$	\$	\$ 3,985	\$ 3,990	\$ 1,992	\$ 2,000
U.S. Government agency mortgage-backed securities			4,054	4,233	6,741	7,147
<b>Total held-to-maturity</b>			<b>8,039</b>	<b>8,223</b>	<b>8,733</b>	<b>9,147</b>
<b>Total</b>	<b>\$ 104,046</b>	<b>\$ 103,806</b>	<b>\$ 96,926</b>	<b>\$ 96,208</b>	<b>\$ 72,311</b>	<b>\$ 73,687</b>

**Securities Portfolio Maturities and Yields.** The following table sets forth the contractual maturities and weighted average yields of our securities portfolio at June 30, 2014. Mortgage-backed securities are anticipated to be repaid in advance of their contractual maturities as a result of projected mortgage loan prepayments. The weighted average life of the mortgage-backed securities in our portfolio at June 30, 2014 was 4.2 years.

	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
(Dollars in thousands)						
<b>Securities available-for-sale:</b>						
FHLMC common stock	\$	%\$		%\$		%
Preferred stock						
Certificates of deposit	1,992	1.19	3,735	1.12	1,494	1.68
Municipal securities					2,847	1.96
U.S. Government agency mortgage-backed securities			53,271	1.81	7,471	1.71
U.S. Government agency bonds	2,010	1.48	14,982	1.52	8,954	1.46



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Total available-for-sale	\$	4,002	1.33%	\$	71,988	1.71%	\$	20,766	1.64%
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	More than Ten Years Amortized Cost	Weighted Average Yield	Total Amortized Cost	Weighted Average Yield
(Dollars in thousands)				
Securities available-for-sale:				
FHLMC common stock	\$ 20	%\$	20	%
Preferred stock	271	6.64	271	6.64
Certificates of deposit			7,221	1.25
Municipal securities	2,998	2.15	5,846	2.06
U.S. Government agency mortgage-backed securities			60,742	1.80
U.S. Government agency bonds	4,000	1.44	29,946	1.49
 Total available-for-sale	 \$ 7,289	 1.92%	 \$ 104,046	 1.70%

**Sources of Funds**

**General.** Deposits have traditionally been our primary source of funds for use in lending and investment activities. We also may use borrowings, primarily Federal Home Loan Bank of Atlanta advances, to supplement cash flow needs, lengthen the maturities of liabilities for interest rate risk purposes and to manage the cost of funds. In addition, we receive funds from scheduled loan payments, investment maturities, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing interest rates, market conditions and levels of competition.

**Deposits.** Our deposits are solely from residents of Oconee County, South Carolina and from persons outside Oconee County with whom we have an existing banking relationship. We offer a selection of deposit accounts, including demand accounts, NOW accounts, money market accounts, savings accounts, certificates of deposit and individual retirement accounts ("IRAs"). Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. We do not accept brokered deposits, although we have the authority to do so. We very rarely accept certificates of deposit in excess of \$250 thousand or other deposits in excess of applicable FDIC insurance coverage, which is currently \$250 thousand per depositor.

Interest rates paid, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market rates, liquidity requirements, rates paid by competitors and growth goals. We rely upon personalized customer service, long-standing relationships with customers, and the favorable image of Oconee Federal Savings and Loan Association in the community to attract and retain deposits. We also offer a fully functional electronic banking platform, including on-line bill pay, as a service to our deposit customers.

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

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

	At June 30,					
	2014		2013		2012	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
NOW and demand deposits(1)	\$ 26,334	9.37%	\$ 23,410	8.01%	\$ 20,456	6.97%
Money market deposits	12,459	4.43	12,238	4.19	11,988	4.09
Regular savings and other deposits	41,945	14.93	38,823	13.28	35,152	11.98
Certificates of deposit IRA	54,646	19.45	57,054	19.51	58,873	20.07
Certificates of deposit other	145,631	51.82	160,897	55.01	166,899	56.89
Total	\$ 281,015	100.00%	\$ 292,422	100.00%	\$ 293,368	100.00%

(1) Includes non-interest bearing deposits of \$4.1 million and \$4.9 million at June 30, 2014 and 2013, respectively.

As of June 30, 2014, the aggregate amount of our outstanding certificates of deposit in amounts greater than or equal to \$100 thousand was approximately \$64.5 million. The following table sets forth the maturity of these certificates of deposit as of June 30, 2014.

June 30, 2014 Certificates of Deposit (Dollars in thousands)	
<b>Maturity Period:</b>	
Three months or less	\$ 13,479
Over three through six months	12,215
Over six through twelve months	21,850
Over twelve months	16,941
Total	\$ 64,485

The following table sets forth the amount and maturities of our time certificates of deposit at June 30, 2014.

	Period to Maturity					Total	Percentage of Total Certificate Accounts
	Less Than One Year	Over One Year to Two Years	Over Two Years to Three Years	Over Three Years			
	(Dollars in thousands)						
<b>Interest Rate:</b>							
Less than 1.00%	\$ 149,694	\$ 32,526	\$ 4,354	\$ 984	\$ 187,558	93.65%	
1.00% - 1.99%	7,789	2,439	327		10,555	5.27	
2.00% - 2.99%	2,164				2,164	1.08	
3.00% and above							

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Total	\$	159,647	\$	34,965	\$	4,681	\$	984	\$	200,277	100.00%
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The following table sets forth our certificates of deposit classified by interest rate as of the dates indicated.

	At June 30,		
	2014	2013	2012
	(Dollars in thousands)		
Interest Rate:			
Less than 1.00%	\$ 187,558	\$ 164,791	\$ 92,714
1.00% - 1.99%	10,555	49,099	122,638
2.00% - 2.99%	2,164	4,061	10,352
3.00% and above			68
Total	\$ 200,277	\$ 217,951	\$ 225,772

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

We had no borrowings from the Federal Home Loan Bank of Atlanta at June 30, 2014 and June 30, 2013. At June 30, 2014, we had access to Federal Home Loan Bank of Atlanta advances of up to \$39.5 million. It is possible that we may use Federal Home Loan Bank of Atlanta advances or other short-term borrowings to fund loan demand or to purchase securities in the future.

### **Subsidiary and Other Activities**

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

### **Personnel**

As of June 30, 2014, we had 45 full-time employees and no part-time employees. Our employees are not represented by any collective bargaining group. Management believes that we have good relations with our employees.

## **FEDERAL AND STATE TAXATION**

### **Expense and Tax Allocation**

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

### **Federal Taxation**

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

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

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

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

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

At June 30, 2014, our total federal and South Carolina pre-1988 base year tax bad debt reserve was approximately \$5.3 million. Under current law, pre-1988 federal base year reserves remain subject to recapture if a thrift institution makes certain non-dividend distributions, certain repurchases any of its stock, pays dividends in excess of tax earnings and profits, or ceases to maintain a thrift or bank charter.

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

**Net Operating Loss Carryovers.** A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. At June 30, 2014, Oconee

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Federal Savings and Loan Association had no net operating loss carryforwards for federal and state income tax purposes.

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

**State and Local Taxation**

**South Carolina State Taxation.** Oconee Federal Financial Corp. and Oconee Federal Savings and Loan Association are required to file South Carolina income tax returns and pay tax at a stated tax rate of 5% and 6%, respectively, of South Carolina taxable income. For these purposes, South Carolina taxable income generally means federal taxable income subject to certain modifications, primarily the exclusion of interest income on United States obligations, state income tax deductions, and adjustments for bonus depreciation deductions.

**SUPERVISION AND REGULATION**

**General**

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

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

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

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**Federal Legislation**

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

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

The Dodd-Frank Act broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution, rather than on total deposits. The legislation also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor, retroactive to January 1, 2008, and noninterest-bearing transaction accounts had unlimited deposit insurance through December 31, 2013. The Dodd-Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not. Further, the legislation requires that originators of securitized loans retain a percentage of the risk for transferred loans, directs the Federal Reserve Board to regulate pricing of certain debit card interchange fees and contains a number of reforms related to mortgage origination.

Many provisions of the Dodd-Frank Act involve delayed effective dates and/or require implementing regulations or have not been issued in final form. Their impact on our operations cannot yet fully be assessed. However, there is a significant possibility that the Dodd-Frank Act will result in an increased regulatory burden and compliance, operating and interest expense for Oconee Federal Savings and Loan Association and Oconee Federal Financial Corp.

**Federal Banking Regulation**

**Business Activities.** A federal savings and loan association derives its lending and investment powers from the Home Owners' Loan Act, as amended, and the federal regulations thereunder. Under these laws and regulations, Oconee Federal Savings and Loan Association may invest in mortgage loans secured by residential and commercial real estate, commercial business and consumer loans, certain types of debt securities and certain other assets, subject to applicable limits. Oconee Federal Savings and Loan Association also may establish subsidiaries that may engage in certain activities not otherwise



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permissible for Oconee Federal Savings and Loan Association, including real estate investment and securities and insurance brokerage. The Dodd-Frank Act authorized banks and savings and loan associations to pay interest on business checking accounts, effective July 21, 2011.

**Capital Requirements.** Federal regulations require savings and loan associations to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for institutions receiving the highest rating on the CAMELS rating system) and an 8% risk-based capital ratio. The prompt corrective action standards discussed below, in effect, establish a minimum 2% tangible capital standard. At June 30, 2014, Oconee Federal Savings and Loan Association's capital exceeded all applicable requirements.

The risk-based capital standard for savings and loan associations requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the regulators, based on the risks believed inherent in the type of asset. Core capital is defined as common stockholders' equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings and loan association that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the recourse back to the savings and loan association. In assessing capital adequacy, the regulators consider not only ratios, but also qualitative factors. The regulators have the authority to establish individual minimum capital requirements on a case-by-case basis.

**New Capital Rule.** On July 9, 2013, the OCC and the other federal bank regulatory agencies issued a final rule that will revise their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions, top-tier bank holding companies with total consolidated assets of \$500 million or more and top-tier savings and loan holding companies.

The rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4.0% to 6.0% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property.

The rule also includes changes in what constitutes regulatory capital, some of which are subject to a two-year transition period. These changes include the phasing-out of certain instruments as qualifying capital. In addition, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common stock will be required to be deducted from capital, subject to a two-year transition period. Finally, Tier 1 capital will include accumulated other comprehensive income (which includes all unrealized gains and losses on available for sale debt and equity securities), subject to a two-year transition period. Oconee Federal Savings and Loan Association has the one-time option in the first quarter of 2015 to permanently opt out of the inclusion of accumulated other comprehensive income in its capital calculation. Oconee Federal Savings and Loan

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Association is considering whether to opt out in order to reduce the impact of market volatility on its regulatory capital levels.

The new capital requirements also include changes in the risk-weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and non-residential mortgage loans that are 90 day past due or otherwise on non-accrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (up from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital; and increased risk-weights (from 0% to up to 600%) for equity exposures.

Finally, the rule limits capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements.

The final rule becomes effective for Oconee Federal Savings and Loan Association and Oconee Federal Financial Corp. on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets increasing each year until fully implemented at 2.5% on January 1, 2019.

We have conducted a pro forma analysis of the application of these new capital requirements as of June 30, 2014. We have determined that we meet all of these new requirements, including the full 2.5% capital conservation buffer, as if these new requirements had been in effect on that date.

**Loans-to-One Borrower.** Generally, a federal savings and loan association may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of June 30, 2014, Oconee Federal Savings and Loan Association's largest lending relationship with a single or related group of borrowers totaled \$3.1 million, which represented 3.9% of unimpaired capital and surplus; therefore, Oconee Federal Savings and Loan Association was in compliance with the loans-to-one borrower limitations.

**Qualified Thrift Lender Test.** As a federal savings and loan association, Oconee Federal Savings and Loan Association is subject to a qualified thrift lender, or "QTL" test. Under the QTL test, Oconee Federal Savings and Loan Association must maintain at least 65% of its "portfolio assets" in "qualified thrift investments" in at least nine months of the most recent 12-month period. "Portfolio assets" generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings and loan association's business.

"Qualified thrift investments" includes various types of loans made for residential and housing purposes, investments related to such purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. "Qualified thrift investments" also include 100% of an institution's credit card loans, education loans and small business loans. Oconee Federal Savings and Loan Association also may satisfy the QTL test by qualifying as a "domestic building and loan association" as defined in the Internal Revenue Code.

A savings and loan association that fails the qualified thrift lender test must operate under specified restrictions set forth in the Home Owners' Loan Act. In addition, the Dodd-Frank Act made non-compliance with the QTL test subject to agency enforcement action for a violation of law. At

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June 30, 2014, Oconee Federal Savings and Loan Association maintained approximately 94.54% of its portfolio assets in qualified thrift investments and, therefore, satisfied the QTL test.

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

the total capital distributions for the applicable calendar year exceed the sum of the association's net income for that year to date plus the association's retained net income for the preceding two years;

the association would not be at least adequately capitalized following the distribution;

the distribution would violate any applicable statute, regulation, agreement or regulatory-imposed condition; or

the association is not eligible for expedited treatment of its application or notice filings.

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

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

the association would be undercapitalized following the distribution;

the proposed capital distribution raises safety and soundness concerns; or

the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

In addition, the Federal Deposit Insurance Act provides that an insured depository institution shall not make any capital distribution, if after making such distribution, the institution would fail to meet any regulatory capital requirement. A federal savings association also may not make a capital distribution that would reduce its regulatory capital below the amount required for the liquidation account established in connection with its conversion to stock form. In addition, beginning in 2016, Oconee Federal Savings and Loan Association's ability to pay dividends will be limited if Oconee Federal Savings and Loan Association does not have the capital conservation buffer required by the new capital rules, which may limit the ability of Oconee Federal Financial Corp. to pay dividends to its stockholders. See " *New Capital Rule.*"

**Liquidity.** A federal savings and loan association is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation. We seek to maintain a ratio of liquid assets not subject to pledge as a percentage of deposits and borrowings of 4.0% or greater of highly liquid assets. At June 30, 2014, this ratio was 4.2%. Total cash and cash equivalents and investments was 33.4% at June 30, 2014.

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



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

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

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

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

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

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

**Standards for Safety and Soundness.** Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards

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required under federal law. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit systems, credit underwriting, loan documentation, interest rate risk exposure, asset growth, compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to implement an acceptable compliance plan.

**Prompt Corrective Action Regulations.** Under the prompt corrective action regulations, the regulators are authorized and, under certain circumstances, required to take supervisory actions against undercapitalized savings and loan associations. For this purpose, a savings and loan association is placed in one of the following five categories based on the association's capital:

well-capitalized (at least 5% leverage capital, 6% Tier 1 risk-based capital and 10% total risk-based capital);

adequately capitalized (at least 4% leverage capital, 4% Tier 1 risk-based capital and 8% total risk-based capital);

undercapitalized (less than 8% total risk-based capital, 4% Tier 1 risk-based capital or 3% leverage capital);

significantly undercapitalized (less than 6% total risk-based capital, 3% Tier 1 risk-based capital or 3% leverage capital); and

critically undercapitalized (less than 2% tangible capital).

Generally, a receiver or conservator for a savings and loan association that is "critically undercapitalized" must be appointed within specific time frames. The regulations also provide that a capital restoration plan must be filed within 45 days of the date a savings and loan association receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Any holding company for the savings and loan association required to submit a capital restoration plan must guarantee the lesser of (i) an amount equal to 5% of the association's assets at the time it was notified or deemed to be undercapitalized by regulator, or (ii) the amount necessary to restore the savings and loan association to adequately capitalized status. This guarantee remains in place until the association is notified that it has maintained adequately capitalized status for each of four consecutive calendar quarters. Additional measures with respect to undercapitalized institutions include a prohibition on capital distributions, growth limits and restrictions on activities. A number of discretionary supervisory actions may also be taken against undercapitalized associations, including the issuance of a capital directive and the replacement of senior executive officers and directors.

At June 30, 2014, Oconee Federal Savings and Loan Association met the criteria for being considered "well-capitalized."

In addition, the final capital rule adopted in July 2013 revises the prompt corrective action categories to incorporate the revised minimum capital requirements of that rule when it becomes effective. The OCC's prompt corrective action standards will change when these new capital ratios become effective. Under the new standards, in order to be considered well-capitalized, Oconee Federal Savings and Loan Association would have to have a common equity Tier 1 ratio of 6.5% (new), a Tier 1 risk-based capital ratio of 8.0% (increased from 6.0%), a total risk-based capital ratio of 10.0% (unchanged), and a Tier 1 leverage ratio of 5.0% (unchanged). Oconee Federal Savings and Loan Association has conducted a pro forma analysis of the application of these new capital requirements as of June 30, 2014. We have determined that Oconee Federal Savings and Loan Association is

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well-capitalized under these new standards, as if these new requirements had been in effect on that date. See " New Capital Rule."

**Insurance of Deposit Accounts.** Deposit accounts in Oconee Federal Savings and Loan Association are insured by the FDIC's Deposit Insurance Fund, generally up to a maximum of \$250 thousand per separately insured depositor and up to a maximum of \$250 thousand for self-directed retirement accounts. The FDIC assesses insured depository institutions to maintain the Deposit Insurance Fund. No institution may pay a dividend if in default of its deposit insurance assessment.

Under the FDIC's risk-based assessment system, insured institutions are assigned to a risk category based on supervisory evaluations, regulatory capital levels and other factors. An institution's assessment rate depends upon the category to which it is assigned and certain adjustments specified by the FDIC, with less risky institutions paying lower assessments. Until recently, assessment rates ranged from seven to 77.5 basis points of assessable deposits.

In February 2011, the FDIC published a final rule under the Dodd-Frank Act to reform the deposit insurance assessment system. The rule redefined the assessment base used for calculating deposit insurance assessments effective April 1, 2011. Under the new rule, assessments are based on an institution's average consolidated total assets minus average tangible equity instead of total deposits. The proposed rule revised the assessment rate schedule to establish assessments ranging from 2.5 to 45 basis points.

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

In addition to the FDIC assessments, the Financing Corporation ("FICO") is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. For the quarter ended June 30, 2014, the annualized FICO assessment rate equaled 0.64 basis points of total assets less tier 1 capital. The bonds issued by the FICO are due to mature in 2017 through 2019.

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

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

**Federal Home Loan Bank System.** Oconee Federal Savings and Loan Association is a member of the Federal Home Loan Bank System, which consists of twelve regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions as well as other entities involved in home mortgage lending. As a member of the Federal Home Loan Bank of Atlanta, Oconee Federal Savings and Loan Association is required to acquire and hold shares of capital stock in the Federal Home Loan Bank. As of June 30, 2014, Oconee Federal Savings and Loan Association was in compliance with this requirement.

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**Federal Reserve System**

Federal Reserve Board regulations require savings and loan associations to maintain noninterest-earning reserves against their transaction accounts, such as negotiable order of withdrawal and regular checking accounts. At June 30, 2014, Oconee Federal Savings and Loan Association was in compliance.

**Other Regulations**

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

Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one-to-four family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;

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

Truth in Savings Act; and

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

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

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

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

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

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



The USA PATRIOT Act, which requires savings and loan associations to, among other things, establish broadened anti-money laundering compliance programs, and due diligence policies and

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controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements that also apply to financial institutions under the Bank Secrecy Act and the Office of Foreign Assets Control regulations; and

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

**Holding Company Regulation**

**General.** Oconee Federal, MHC and Oconee Federal Financial Corp. are non-diversified savings and loan holding companies within the meaning of the Home Owners' Loan Act. As such, Oconee Federal, MHC and Oconee Federal Financial Corp. are registered savings and loan holding companies and are subject to regulations, examinations, supervision and reporting requirements. In addition, holding company regulators have enforcement authority over Oconee Federal Financial Corp. and Oconee Federal, MHC, and their non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a serious risk to Oconee Federal Savings and Loan Association.

**Permitted Activities.** Pursuant to federal law, regulations and policy, a mutual holding company, such as Oconee Federal, MHC, and a federally chartered mid-tier holding company such as Oconee Federal Financial Corp. generally may engage in the following activities: (i) investing in the stock of a savings association; (ii) acquiring a mutual association through the merger of such association into a savings association subsidiary of such holding company or an interim savings association subsidiary of such holding company; (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings association; (iv) investing in a corporation, the capital stock of which is available for purchase by a savings association under federal law or under the law of any state where the subsidiary savings association or associations share their home offices; (v) furnishing or performing management services for a savings association subsidiary of such company; (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (vii) holding or managing properties used or occupied by a savings association subsidiary of such company; (viii) acting as trustee under deeds of trust; (ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987; and (x) any activity permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act, including securities and insurance underwriting.

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

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

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

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

**Capital.** Savings and loan holding companies historically have not been subject to consolidated regulatory capital requirements. The Dodd-Frank Act, however, requires the Federal Reserve Board to establish for all depository institution holding companies minimum consolidated capital requirements that are as stringent as those required for the insured depository subsidiaries. Under regulations recently enacted by the Federal Reserve Board, Oconee Federal Financial Corp. and Oconee Federal, MHC are subject to regulatory capital requirements that generally are the same as the new capital requirements for Oconee Federal Savings and Loan Association. These new capital requirements include provisions that might limit the ability of Oconee Federal Financial Corp. to pay dividends to its stockholders or repurchase its shares. See " Federal Banking Regulation New Capital Rule." Oconee Federal Financial Corp. has conducted a pro forma analysis of the application of these new capital requirements as of June 30, 2014, and has determined that it will meet all of these new requirements, including the full 2.5% capital conservation buffer, and will remain well-capitalized, as if these new requirements had been in effect on that date.

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

**Dividends.** The Federal Reserve Board has issued a policy statement regarding the payment of dividends and the repurchase of shares of common stock by bank holding companies and savings and

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

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

**Federal Securities Laws**

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

**Sarbanes-Oxley Act of 2002**

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

**ITEM 1A. Risk Factors**

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

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None.

**ITEM 2. Properties**

As of June 30, 2014, the net book value of our properties was \$2.8 million. The following is a list of our offices:

Location		Year Acquired or Leased	Square Footage	Net Book Value of Real Property
(Dollars in thousands)				
<b>Main Office:</b>				
115 E. North 2 <sup>nd</sup> St. Seneca, South Carolina	Owned	1966	7,000	\$ 953
<b>Main Office Annex:</b>				
201 E. North 2 <sup>nd</sup> St. Seneca, South Carolina	Owned	1996	7,500	674
<b>Branch Offices:</b>				
813 123 By-Pass Seneca, South Carolina	Owned	1985	5,250	513
204 W. North Broad St. Walhalla, South Carolina	Owned	1973	3,100	409
111 W. Windsor St. Westminster, South Carolina	Owned	1972	3,200	291
				\$ 2,840

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

**ITEM 3. Legal Proceedings**

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

At June 30, 2014, we were not involved in any legal proceedings the outcome of which would be material to our financial condition or results of operations.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

Table of Contents**PART II****ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

**Market.** Our common stock is listed on the Nasdaq Capital Market under the symbol "OFED." The approximate number of holders of record of our common stock as of September 26, 2014 was 325. Certain shares of our common stock are held in "nominee" or "street" name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

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

	High	Low	Dividends
Quarter ended June 30, 2014	\$ 20.50	\$ 16.95	\$ 0.10
Quarter ended March 31, 2014	\$ 17.75	\$ 16.73	\$ 0.10
Quarter ended December 31, 2013	\$ 17.75	\$ 16.48	\$ 0.10
Quarter ended September 30, 2013	\$ 17.49	\$ 14.69	\$ 0.10
Quarter ended June 30, 2013	\$ 15.78	\$ 13.73	\$ 0.10
Quarter ended March 31, 2013	\$ 16.49	\$ 14.42	\$ 0.10
Quarter ended December 31, 2012	\$ 18.30	\$ 14.36	\$ 0.10
Quarter ended September 30, 2012	\$ 15.70	\$ 12.28	\$ 0.10

**Dividends.** We are generally permitted to pay dividends on our common stock if, after giving effect to the distribution, we would be able to pay its indebtedness as the indebtedness comes due in the usual course of business and our total assets exceed the sum of its liabilities and the amount needed, if we were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of any holders of capital stock who have a preference in the event of dissolution. The holders of our common stock will be entitled to receive and share equally in dividends as may be declared by our board of directors out of funds legally available therefore. If we issue shares of preferred stock, the holders thereof may have a priority over the holders of our common stock with respect to dividends. We currently intend to continue to declare and pay a quarterly cash dividend on the common stock equal to \$0.10 per share following our board of directors' periodic review of our financial condition and results of operations for each fiscal quarter. The dividend rate and the continued payment of dividends will depend upon our board of directors' consideration of a number of factors, including investment opportunities available to us, capital requirements, our financial condition and results of operations, and statutory and regulatory limitations, tax considerations and general economic conditions. There can be no assurance that our quarterly cash dividend will not be reduced or eliminated in future periods.

Dividend payments by Oconee Federal Financial Corp. are dependent primarily on dividends it receives from Oconee Federal Savings and Loan Association, because Oconee Federal Financial Corp. will have no source of income other than dividends from Oconee Federal Savings and Loan Association, earnings from the investments by Oconee Federal Financial Corp. and interest payments with respect to our loan to the Employee Stock Ownership Plan. Oconee Federal Savings and Loan Association is not permitted to make a capital distribution if, after making such distribution, it would be undercapitalized. In addition, a newly adopted capital rule limits capital distributions and certain discretionary bonus payments if a banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets increasing each year until full implemented at 2.5% on January 1, 2019. For information concerning additional

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federal laws and regulations regarding the ability of Oconee Federal Savings and Loan Association to make capital distributions, including the payment of dividends to Oconee Federal Financial Corp., see "Supervision and Regulation Federal Banking Regulation" and " Holding Company Regulation."

When Oconee Federal Financial Corp. pays dividends on its common stock to public shareholders, it will also be required to pay dividends to Oconee Federal, MHC, unless Oconee Federal, MHC elects to, and is permitted to, waive the receipt of dividends. To date, the Federal Reserve Board generally has not permitted dividend waivers by mutual holding companies and there can be no assurance that a dividend waiver request would be approved by the Federal Reserve Board.

**Equity Compensation Plans.** At June 30, 2014, there were no compensation plans under which equity securities of Oconee Federal Financial Corp. were authorized for issuance other than the Employee Stock Ownership Plan and the Equity Incentive Plan.

**Issuer Repurchases.** The following table sets forth information in connection with repurchases of the Company's common stock for the period April 1, 2014 through June 30, 2014. On June 19, 2013, the Board of Directors authorized the repurchase of up to 150,000 shares of the Company's common stock. The repurchase authorization has no expiration date. In connection with this repurchase authorization, the Company has purchased a total of 101,500 shares of its common stock.

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Approximate Maximum Dollar Value or Number of Shares That May Yet be Purchased Under Publicly Announced Plan
April 1 - April 30, 2014		\$		50,000
May 1 - May 31, 2014	1,500	17.70	1,500(1)	48,500
June 1 - June 30, 2014				48,500(2)
<b>Total</b>	1,500	\$ 17.70	1,500	

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(1) All shares were purchased pursuant to a publicly announced repurchase program that was approved by the Board of Directors on June 19, 2013.

(2) Represents the maximum number of shares available for repurchase under the June 19, 2013 plan at June 30, 2014.

**Sales of Unregistered Securities.** During the year ended June 30, 2014, we did not offer or sell any unregistered securities.

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	At or For the Year Ended June 30,				
	2014	2013	2012	2011	2010
	(Dollars in thousands)				
<b>Financial condition data:</b>					
Total assets	\$ 360,501	\$ 370,095	\$ 377,753	\$ 374,277	\$ 333,546
Investment securities	103,806	96,024	73,273	39,666	12,150
Loans receivable, net	229,931	221,163	249,832	264,913	264,328
Deposits	281,015	292,422	293,368	292,469	272,606
Total equity(1)	76,981	76,162	82,984	80,211	59,661
<b>Operating data:</b>					
Interest and dividend income	\$ 12,976	\$ 13,992	\$ 15,269	\$ 15,242	\$ 15,084
Interest expense	1,480	2,174	3,202	4,947	5,980
Net interest income	11,496	11,818	12,067	10,295	9,104
Provision for loan losses	108	260	270	135	758
Non-interest income	608	410	412	98	237
Non-interest expenses	6,307	5,496	5,624	6,593	4,583
Income before income taxes	5,689	6,472	6,585	3,665	4,000
Income taxes	2,050	2,432	2,572	1,366	1,407
Net income	\$ 3,639	\$ 4,040	\$ 4,013	\$ 2,299	\$ 2,593

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- (1) Total equity prior to June 30, 2011 consisted of retained earnings and accumulated other comprehensive income for Oconee Federal Savings and Loan Association's investment in FHLMC common stock, which is classified as available-for-sale.



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	For the years ended June 30,				
	2014	2013	2012	2011	2010
<b>Performance ratios:</b>					
Return on average assets	1.00%	1.08%	1.07%	0.63%	0.80%
Return on average equity	4.78	5.00	4.89	3.11	4.43
Interest rate spread(1)	3.20	3.10	3.26	2.61	2.53
Net interest margin(2)	3.30	3.25	3.31	2.94	2.91
Noninterest expense to average assets	1.74	1.46	1.49	1.82	1.42
Efficiency ratio(3)	53.13	45.44	45.07	63.49	48.98
Average interest-earning assets to average interest-bearing liabilities	1.24X	1.26X	1.27X	1.23X	1.20X
End of year equity to average assets	21.22%	20.30%	22.05%	22.13%	18.45%
Average equity to average assets	20.98	21.54	21.79	20.37	18.11
<b>Capital ratios:</b>					
Total capital to risk weighted assets	42.31%	44.29%	45.25%	37.19%	38.20%
Tier I capital to risk weighted assets	41.73	43.83	44.74	36.81	37.64
Tier I capital to average assets	19.61	19.62	19.94	18.88	17.86
<b>Asset quality ratios:</b>					
Allowance for loan losses as a percentage of total loans	0.37%	0.34%	0.34%	0.28%	0.33%
Allowance for loan losses as a percentage of nonperforming loans	51.91	37.81	37.23	47.80	22.32
Allowance for loan losses as a percentage of nonperforming assets	35.76	24.76	27.15	19.60	18.78
Net charge-offs to average outstanding loans during the period	0.00	0.16	0.06	0.10	0.05
Non-performing loans as a percentage of total loans	0.71	0.89	0.91	0.59	1.49
Non-performing assets as a percentage of total assets	0.66	0.82	0.84	1.02	1.42
Non-performing assets as a percentage of loans and real estate owned	1.03	1.35	1.25	1.42	1.77
<b>Other:</b>					
Number of full-service branch offices	4	4	4	4	4

- (1) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.
- (2) Represents net interest income as a percent of average interest-earning assets.
- (3) Represents noninterest expense divided by the sum of net interest income and noninterest income, excluding gains or losses on the sale of securities.

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**ITEM 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

**Overview**

Oconee Federal Savings and Loan Association has historically operated as a traditional thrift institution headquartered in Seneca, South Carolina. Our principal business consists of attracting retail deposits from the general public in our market area and investing those deposits, together with funds generated from operations, in one-to-four family residential mortgage loans and, to a much lesser extent, non-residential mortgage, construction and land and other loans. We also invest in U.S. Government and federal agency securities and mortgage-backed securities. Our revenues are derived principally from the interest on loans and securities and loan fees and service charges. Our primary sources of funds are deposits and principal and interest payments on loans and securities. At June 30, 2014, we had total assets of \$360.5 million, total deposits of \$281.0 million and total equity of \$77.0 million.

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

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

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

**Critical Accounting Policies**

We consider accounting policies that require management to exercise significant judgment or discretion or make significant assumptions that have, or could have, a material impact on the carrying value of certain assets or on income, to be critical accounting policies. We consider the following to be our critical accounting policies:

***Allowance for Loan Losses.*** Our allowance for loan losses is the estimated amount considered necessary to reflect probable losses inherent in the loan portfolio at the balance sheet date. The

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allowance is established through the provision for loan losses, which is charged against income. In determining the allowance for loan losses, management makes significant estimates and has identified this policy as one of the most critical for us. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

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

Management performs a quarterly evaluation of the allowance for loan losses. The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans that are determined to be impaired. Impairment loss is measured by determining the present value of expected future cash flows or, for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The general allocation is determined by segregating classified loans from the remaining loans, and then categorizing each group by type of loan. Loans within each type exhibit common characteristics including terms, collateral type, and other risk characteristics. In determining the amount of the allowance for loan losses, we apply loss factors to each category of loan. We estimate our loss factors taking into consideration both quantitative and qualitative aspects that would affect our estimation of probable incurred losses. These aspects include, but are not limited to historical charge-offs; loan delinquencies and foreclosure trends; current economic trends and demographic data within Oconee County and the other surrounding areas, such as unemployment rates and population trends; current trends in real estate values within the Oconee County market area; charge-off trends of other comparable institutions; the results of any internal loan reviews; loan-to-value ratios; our historically conservative credit risk policy; the strength of our underwriting and ongoing credit monitoring function; and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision based on changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses we have established, which could have a material negative effect on our financial results.

**Deferred Income Taxes.** We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. These judgments and estimates are reviewed on a continual basis as regulatory and business factors change.

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

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**Business Strategy**

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

***Continue to Focus on Residential Lending.*** We have been and will continue to be primarily a one-to-four family residential mortgage lender for borrowers in our market area. As of June 30, 2014, \$215.0 million, or 92.7%, of our total loan portfolio consisted of one-to-four family residential mortgage loans (including home equity loans). In the future, we may gradually increase our residential construction and home equity loan portfolios.

***Maintain a Modest Portfolio of Non-residential Mortgage Loans.*** We have historically maintained a small portfolio of non-residential mortgage loans, primarily loans to churches located in our market area. As of June 30, 2014, \$8.4 million, or 3.6%, of our total loan portfolio, were non-residential mortgages or non-residential construction and land loans, of which \$8.3 million were loans to churches. We believe that loans to churches enhance our presence in the community and help expand our financial services business as congregation members become familiar with us.

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

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

***Adhere to Conservative Underwriting Guidelines to Maintain Strong Asset Quality.*** We have emphasized maintaining strong asset quality by following conservative underwriting guidelines, sound loan administration, and focusing on loans secured by real estate located within our market area only. Our non-performing assets totaled \$2.4 million, or 0.66% of total assets at June 30, 2014. Our total nonperforming loans to total loans ratio was 0.71% at June 30, 2014. Total loan delinquencies, 30 days or more past due, as of June 30, 2014, were \$6.9 million, or 3.0% of total loans.

**Comparison of Financial Condition at June 30, 2014 and June 30, 2013**

Our total assets decreased by \$9.6 million, or 2.6%, to \$360.5 million at June 30, 2014 from \$370.1 million at June 30, 2013. This decrease is primarily attributable to the decrease in our deposits of \$11.4 million, or 3.90%, to \$281.0 million at June 30, 2014 from \$292.4 million at June 30, 2013. The decline in our total deposits is attributed to the sustained low interest rate environment. Some depositors have moved their deposits away from financial institutions and into the market place seeking higher yields on their money. Net loans increased by \$8.8 million, or 4.0%, to \$229.9 million at June 30, 2014 from \$221.2 million at June 30, 2013, reflecting the increased demand during the year 2014 as compared with 2013. Total investment securities increased \$7.8 million, or 8.1%, to

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\$103.8 million at June 30, 2014 from \$96.0 million at June 30, 2013. The increase in our investment securities is a reflection of our efforts to decrease the amount of cash held in low earning correspondent accounts and increase the amount invested in higher-yielding debt securities.

Deposits decreased by \$11.4 million, or 3.9%, to \$281.0 million at June 30, 2014 from \$292.4 million at June 30, 2013. The decrease in deposits reflected a decrease in certificates of deposit of \$17.7 million, or 8.1%, offset partially by an increase in NOW, money market and regular savings accounts of \$6.3 million, or 8.4%. The decline in our certificates of deposits is reflective of depositors moving their deposits into higher yielding investments in the market during this sustained low interest rate environment. Oconee Federal MHC's cash is held on deposit with the Company. We generally do not accept brokered deposits and no brokered deposits were accepted during the year ended June 30, 2014.

We had no advances from the Federal Home Loan Bank of Atlanta as of June 30, 2014 and 2013. We have credit available under a loan agreement with the Federal Home Loan Bank of Atlanta in the amount of 11% of total assets, or approximately \$39.5 million at June 30, 2014.

Total equity increased \$819 thousand to \$77.0 million at June 30, 2014 from \$76.2 million at June 30, 2013. The increase is the result of net income for the year ended June 30, 2014 of \$3.6 million plus a decrease in accumulated other comprehensive loss of \$412 thousand, and the approximate \$600 thousand net positive effects of a reduction in unearned ESOP and recognition of compensation expense associated with our equity incentive plans, which both increase equity. These increases to equity were offset by treasury stock repurchases of \$1.6 million and dividends of \$2.2 million.

### **Comparison of Operating Results for the Years Ended June 30, 2014 and June 30, 2013**

**General.** Net income decreased by \$401 thousand, or 9.9%, to \$3.6 million for the year ended June 30, 2014 from \$4.0 million for the year ended June 30, 2013. The decrease in net income was the result of a decrease in net interest income before the provision for loan losses of \$322 thousand, or 2.7%, and an increase in noninterest expenses of \$811 thousand, or 14.8%, offset partially by an increase of \$198 thousand, or 48.3%, in noninterest income and a decrease in income tax expense of \$382 thousand, or 15.7%.

**Interest Income.** Interest income decreased by \$1.0 million, or 7.3%, to \$13.0 million for the year ended June 30, 2014 from \$14.0 million for the year ended June 30, 2013. The decrease was the result of both a decline in the average balance of interest-earning assets and a decline in the yield on interest earning assets during the year ended June 30, 2014 as compared to the year ended June 30, 2013. The average balance of interest-earning assets decreased by \$15.9 million, or 4.4%, to \$347.9 million for the year ended June 30, 2014 from \$363.9 million for the year ended June 30, 2013. The yield on interest earning assets decreased 12 basis points to 3.73% for the year ended June 30, 2014 from 3.85% for the year ended June 30, 2013. The decline in the average balance of our interest-earning assets is primarily the result of the decline in our cash and cash equivalents due to the decline in our deposits during the year ended June 30, 2014.

Interest income on loans decreased \$1.4 million, or 10.9%, to \$11.4 million for the year ended June 30, 2014 from \$12.7 million for the year ended June 30, 2013. The decline in interest income on loans reflects both the decline in the average balance of loans and yield on loans for the year ended June 30, 2014 as compared to 2013. The average balance of loans decreased \$11.3 million, or 4.8%, to \$224.3 million for the year ended June 30, 2014 from \$235.6 million for the year ended June 30, 2013. The yield on loans decreased by 34 basis points to 5.07% for the year ended June 30, 2014 from 5.41% for the year ended June 30, 2013. The declining balance of our loan portfolio over fiscal year 2013 led to an overall lower average balance of our loans for fiscal year 2014. However, moderate increases in loan demand and a decrease in early loan payoffs during fiscal year 2014 have led to an increase in our

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overall total loan portfolio balance at June 30, 2014. The decline in the yield on our loans is reflective of the lower interest rate environment that has continued during all of 2014.

Interest income on investment securities increased \$387 thousand, or 33.1%, to \$1.5 million for the year ended June 30, 2014 from \$1.2 million for the year ended June 30, 2013, reflecting an increase of \$16.3 million, or 19.6%, in the average balances of securities to \$99.7 million from \$83.3 million for the years ended June 30, 2014 and 2013 and an increase in the total yield of our investment securities of 16 basis points to 1.56% from 1.40% for the same periods ended. The increase in average balances of our investment securities is reflective of our efforts to continue to invest excess cash liquidity in high-quality investment securities during this period of low loan demand. Additionally, we began investing in high-quality municipal securities to achieve higher investment yields and to reduce our overall tax liability.

**Interest Expense.** Interest expense decreased \$694 thousand, or 32.0%, to \$1.5 million for the year ended June 30, 2014 from \$2.2 million for the year ended June 30, 2013. The decrease reflected a 22 basis point decrease in the average rate paid on deposits in fiscal year 2014 to 0.53% from 0.75% in fiscal year 2013 and the decrease in the average balance of deposits of \$7.8 million, or 2.4%, to \$280.3 million from \$288.1 million for the same periods ended.

Interest expense on certificates of deposit decreased \$697 thousand, or 33.7%, to \$1.40 million for the year ended June 30, 2014 from \$2.1 million for the year ended June 30, 2013. The decrease in interest expense on certificates of deposit reflected a decrease of \$13.6 million, or 6.1%, in the average balance of certificates of deposit to \$209.2 million for the year ended June 30, 2014 from \$222.8 million for the year ended June 30, 2013 and a decrease of 27 basis points in the average cost on certificates of deposit to 0.66% from 0.93% for the same periods ended. Interest expense on money market deposits, NOW and demand deposits, and regular savings and other deposits increased slightly by \$3 thousand to \$107 thousand for the year ended June 30, 2014 from \$104 thousand for the year ended June 30, 2013. The increase was due to the increase in the average balance of these deposits of \$5.8 million, or 8.8%, to \$71.1 million for the year ended June 30, 2014 from \$65.3 million for the year ended June 30, 2013.

**Net Interest Income.** Net interest income decreased by \$322 thousand, or 2.7%, to \$11.5 million for the year ended June 30, 2014 compared to \$11.8 million for the year ended June 30, 2013. The net interest margin for the year ended June 30, 2014 was 3.30%, up 5 basis-points from 3.25% for the year ended June 30, 2013. This increase in net interest margin was solely due to the decrease in our cost of funds as our cost of funds declined to 0.53% for the year ended June 30, 2014 from 0.75% for the year ended June 30, 2013.

**Provision for Loan Losses.** We recorded a provision for loan losses of \$108 thousand for the year ended June 30, 2014 compared with a provision of \$260 thousand for the year ended June 30, 2013. Net charge-offs for the year ended June 30, 2014 were \$4 thousand compared with \$366 thousand for the year ended June 30, 2013. The 2013 net charge-offs were inflated due to one large one-to-four family residential real estate loan charge off during the three months ended March 31, 2013 of \$277 thousand. No significantly large loans were charged off during the year ended June 30, 2014.

The decrease in our provision for loan losses is primarily a reflection of improvements in our loan quality as evidenced by the aforementioned decrease in net charge-offs as well as improvements in past dues and nonperforming loans. Our ratio of nonperforming loans to total loans decreased to 0.71% at June 30, 2014 from 0.89% at June 30, 2013, and our ratio of nonperforming assets to total assets decreased to 0.66% from 0.82% for the same periods. Our total impaired loans decreased modestly to \$1.6 million at June 30, 2014 from \$1.7 million at June 30, 2013; however, the amount of impairment on impaired loans was slightly higher at \$52 thousand at June 30, 2014 compared with \$27 thousand at June 30, 2013.

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We used the same methodology in assessing the allowances for both periods ended. Our allowance at June 30, 2014 reflects both a general valuation component of \$803 thousand and a specific component of \$52 thousand for loans determined to be impaired based upon an analysis of certain individual loans determined to be impaired. In comparison, our allowance at June 30, 2013 consisted of a general valuation component of \$724 thousand and a specific component of \$27 thousand. Overall, our allowance for loan losses to total loans remains relatively consistent at 0.37% at June 30, 2014 compared with 0.34% at June 30, 2013. To the best of our knowledge, we have recorded all losses that are both probable and reasonably estimable for the years ended June 30, 2014 and 2013.

**Noninterest Income.** Noninterest income increased \$198 thousand, or 48.3%, to \$608 thousand for the year ended June 30, 2014 from \$410 thousand for the year ended June 30, 2013. The increase in noninterest income is reflective of increases in income on bank owned life insurance of \$242 thousand, or 372.3%, to \$307 thousand for the year ended June 30, 2014 from \$65 thousand for the year ended June 30, 2013 and gain on sales of securities of \$101 thousand, or 75.9%, to \$234 thousand for the year ended June 30, 2014 from \$133 thousand for the year ended June 30, 2013. These increases were offset by a decrease in gain on sales of real estate owned of \$76 thousand, or 116.9%, to a net loss on sale of real estate owned of \$11 thousand for the year ended June 30, 2014 as compared to a net gain of \$65 thousand for the year ended June 30, 2013, and a decrease in other noninterest income of \$65 thousand, or 97.0%, to \$2 thousand for the year ended June 30, 2014 as compared to \$67 thousand for the year ended June 30, 2013. During the year ended June 30, 2013, approximately \$64 gain was recognized on foreclosure of certain loans whereby the estimated fair value of the real estate collateral exceeded the carrying value of the foreclosed loans. The dramatic increase in income from bank owned life insurance results from the purchase of \$8.0 million of bank owned life insurance in April of 2013. The year ended June 30, 2013 consists only of three months of income on our investment. The increase in gain on sales of securities is due to an increase in sales of securities during 2014 for additional cash liquidity needed to respond to the increase in loan demand and declining deposit balances.

**Noninterest Expense.** Noninterest expense for the year ended June 30, 2014 increased \$811 thousand, or 14.8%, to \$6.3 million for the year ended June 30, 2014 from \$5.5 million for the year ended June 30, 2013. The increase in noninterest expenses is reflective of increases in salaries and employee benefits of \$261 thousand, or 7.8%, to \$3.6 million for the year ended June 30, 2014 from \$3.4 million related to the year ended June 30, 2013, professional and supervisory fees of \$338 thousand, or 77.7%, to \$773 thousand from \$435 thousand for the same periods ended, and provision for real estate owned and related expenses of \$117 thousand, or 82.4%. The increase in salaries and employee benefits is due to an increase during 2014 in salaries for several officer promotions. Normal annual pay increases are included in the overall increase as well. Additionally, compensation expense associated with our ESOP increased by approximately \$118 thousand, of which \$91 thousand is related to additional discretionary contributions made to the ESOP during the year ended June 30, 2014. The remaining increase is the result of increase in our stock price during the year, which results in higher compensation cost associated with the ESOP. The increase in professional and supervisory fees is a result of merger related costs including legal, consulting, accounting and due diligence fees and expenses incurred with the pending Stephens Federal Bank merger. During the year ended June 30, 2014, we recognized \$164 thousand in impairment related to real estate owned properties compared to an amount of \$23 thousand for the year ended June 30, 2013. This increase was the primary reason for the increase in the provision for real estate owned and related expenses.

**Income Tax Expense.** The provision for income taxes was \$2.1 million for year ended June 30, 2014 compared with \$2.4 million at June 30, 2013. Our effective tax rates for the years ended June 30, 2014 and 2013 were 36.0% and 37.5%, respectively. The decrease in our effective tax rates is primarily related to the increase income from bank owned life insurance, which is not taxable for income tax purposes.

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#### Analysis of Net Interest Income

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

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

	For the Year Ended June 30,								
	2014			2013			2012		
	Average	Interest	Yield/	Average	Interest	Yield/	Average	Interest	Yield/
	Balance	and	Cost	Balance	Dividends	Cost	Balance	Dividends	Cost
	(Dollars in Thousands)								
<b>Assets:</b>									
Interest-earning assets:									
Loans	\$ 224,295	\$ 11,365	5.07%	\$ 235,594	\$ 12,749	5.41%	\$ 259,245	\$ 14,264	5.50%
Investment securities	98,901	1,535	1.55	83,342	1,170	1.40	55,296	879	1.59
Investment securities, tax-free	790	22	2.78						
Other interest-earning assets	23,951	54	0.23	44,954	73	0.16	50,364	126	0.25
<b>Total interest-earning assets</b>	<b>347,937</b>	<b>12,976</b>	<b>3.73</b>	<b>363,890</b>	<b>13,992</b>	<b>3.85</b>	<b>364,905</b>	<b>15,269</b>	<b>4.18</b>
Noninterest-earning assets	14,892			11,268			11,881		
<b>Total assets</b>	<b>\$ 362,829</b>			<b>\$ 375,158</b>			<b>\$ 376,786</b>		
<b>Liabilities and equity:</b>									
Interest-bearing liabilities:									
NOW and demand deposits	\$ 18,463	\$ 12	0.06%	\$ 17,584	\$ 12	0.07%	\$ 14,475	\$ 16	0.11%
Money market deposits	12,756	25	0.20	11,859	25	0.21	10,847	27	0.25
Regular savings and other deposits	39,841	70	0.17	35,849	67	0.19	34,384	100	0.29
Certificates of deposit	209,201	1,373	0.66	222,806	2,070	0.93	227,572	3,059	1.34
<b>Total interest-bearing deposits</b>	<b>280,261</b>	<b>1,480</b>	<b>0.53</b>	<b>288,098</b>	<b>2,174</b>	<b>0.75</b>	<b>287,278</b>	<b>3,202</b>	<b>1.11</b>
<b>Total interest-bearing liabilities</b>	<b>280,261</b>	<b>1,480</b>	<b>0.53</b>	<b>288,098</b>	<b>2,174</b>	<b>0.75</b>	<b>287,278</b>	<b>3,202</b>	<b>1.11</b>
Noninterest bearing deposits	4,910			4,194			5,050		
<b>Other noninterest-bearing liabilities</b>	<b>1,531</b>			<b>2,059</b>			<b>2,003</b>		
<b>Total liabilities</b>	<b>286,702</b>			<b>294,351</b>			<b>294,331</b>		
<b>Equity</b>	<b>76,127</b>			<b>80,807</b>			<b>82,455</b>		
<b>Total liabilities and equity</b>	<b>\$ 362,829</b>			<b>\$ 375,158</b>			<b>\$ 376,786</b>		



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Net interest income	\$ 11,496	\$ 11,818	\$ 12,067
Interest rate spread	3.20%	3.10%	3.07%
Net interest margin	3.30%	3.25%	3.31%
Average interest-earning assets to average interest-bearing liabilities	1.24X	1.26X	1.27X

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#### **Rate/Volume Analysis**

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

Year Ended June 30, 2014 Compared to 2013	Volume	Rate	Net
(Dollars in thousands)			
<b>Interest income:</b>			
Loans	\$ (595)	\$ (789)	(1,384)
Investment securities	246	141	387
Other interest-earning assets	(113)	94	(19)
<b>Total</b>	<b>(462)</b>	<b>(554)</b>	<b>(1,016)</b>
<b>Interest expense:</b>			
Deposits	(58)	(636)	(694)
<b>Total</b>	<b>(58)</b>	<b>(636)</b>	<b>(694)</b>
<b>Increase (decrease) in net interest income</b>	<b>\$ (404)</b>	<b>\$ 82</b>	<b>\$ (322)</b>

Year Ended June 30, 2013 Compared to 2012	Volume	Rate	Net
(Dollars in thousands)			
<b>Interest income:</b>			
Loans	\$ (1,283)	\$ (232)	(1,515)
Investment securities	378	(87)	291
Other interest-earning assets	(12)	(41)	(53)
<b>Total</b>	<b>(917)</b>	<b>(360)</b>	<b>(1,277)</b>
<b>Interest expense:</b>			
Deposits	9	(1,037)	(1,028)
<b>Total</b>	<b>9</b>	<b>(1,037)</b>	<b>(1,028)</b>
<b>Increase (decrease) in net interest income</b>	<b>\$ (926)</b>	<b>\$ 677</b>	<b>\$ (249)</b>

**Management of Market Risk**

Our most significant form of market risk is interest rate risk because, as a financial institution, the majority of our assets and liabilities are sensitive to changes in interest rates. Therefore, a principal part of our operations is to manage interest rate risk and limit the exposure of our net interest income to changes in market interest rates. Our board of directors is responsible for the review and oversight of our asset/liability strategies. The Asset/Liability Committee of our board of directors meets monthly and is charged with developing an asset/liability management plan. Our board of directors has established an Asset/Liability Management Committee, consisting of senior management, which meets daily to review pricing and liquidity needs and to assess our interest rate risk. This committee is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate, given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by our board of directors.

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

using pricing strategies in an effort to balance the proportions of 30-year and 15-year fixed rate loans in our portfolio;

maintaining a modest portfolio of adjustable-rate one-to-four family residential loans;

funding a portion of our operations with deposits with terms greater than one year;

focusing our business operations on local retail customers who value our community orientation and personal service and who may be somewhat less sensitive to interest rate changes than wholesale deposit customers; and

maintaining a strong capital position, which provides for a favorable level of interest-earning assets relative to interest-bearing liabilities.

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

An important measure of interest rate risk is the amount by which the net present value of ("NPV") an institution's cash flow from assets, liabilities and off balance sheet items changes in the event of a range of assumed changes in market interest rates. We have prepared an analysis of estimated changes in our NPV under the assumed instantaneous changes in the United States treasury yield curve. The financial model uses a discounted cash flow analysis and an option-based pricing approach to measuring the interest rate sensitivity of the NPV. Set forth below is an analysis of the changes to the economic value of our equity as of June 30, 2014 in the event of designated changes in the United States treasury yield curve. At June 30, 2014, our NPV exposure related to these hypothetical changes in market interest rates was within the current guidelines we have established.

	Net Portfolio Value per Model	Dollar Change from Base	Percentage Change from Base	Percentage Total of Market Value of Assets
(Dollars in thousands)				
Up 300 basis points	\$ 46,229	\$ (26,983)	(36.86)%	(7.42)%
Up 200 basis points	55,395	(17,817)	(24.34)	(4.90)
Up 100 basis points	64,819	(8,393)	(11.46)	(2.31)
Base	73,212			
Down 100 basis points	79,252	6,040	8.25	1.66

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurement. Modeling changes in net portfolio value requires making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the net portfolio value table presented assumes that the composition of our interest-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or repricing of specific assets and liabilities. In addition, this the net portfolio value table does not reflect the impact of a change in interest rates on the credit quality of our assets. Accordingly, although the net portfolio value table provides an indication of our interest

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rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

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

**Liquidity and Capital Resources**

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

Our cash flows are derived from operating activities, investing activities and financing activities. Net cash flows provided by operating activities were \$4.4 million for the year ended June 30, 2014 and \$6.2 million for the year ended June 30, 2013. Net cash flows provided by operating activities consisted primarily of our net income. Net cash flows used in investing activities were (\$15.2) million for the year ended June 30, 2014 and (\$4.7) million for the year ended June 30, 2013. Net cash flows used in investing activities consisted primarily of purchases of investment securities, offset by proceeds from maturities and paydowns on investment securities, and net loan repayments. Net cash flows used in financing activities were (\$15.3) million for the year ended June 30, 2014 and \$11.1 million for the year ended June 30, 2013. Net cash flows used in financing activities consisted primarily of the payment of dividends and share repurchases of our common stock. The increase of \$4.1 million is primarily related to the \$10.5 million increase in net deposit outflow, offset partially by a decrease in treasury share repurchases of \$6.2 million for the year ended June 30, 2014.

Our most liquid assets are cash and short-term investments. The levels of these assets are dependent on our operating, financing, lending, and investing activities during any given period. At June 30, 2014 and 2013, cash and short-term investments totaled \$11.9 million and \$37.9 million, respectively. We may also utilize as sources of funds the sale of securities available-for-sale, federal funds purchased, Federal Home Loan Bank of Atlanta advances and other borrowings.

At June 30, 2014 and 2013, we had outstanding commitments to originate loans of \$3.1 million and \$1.1 million, respectively. We had no unfunded commitments under lines of credit or standby letters of credit at June 30, 2014 and 2013. We anticipate that we will have sufficient funds available to meet our current loan commitments. In recent periods, loan commitments have been funded through liquidity and normal deposit flows. Certificates of deposit scheduled to mature in one year or less from June 30, 2014 totaled \$159.6 million. Management believes based on past experience that a significant portion of such deposits will remain with us. Based on the foregoing, in addition to our level of core deposits and capital, we consider our liquidity and capital resources sufficient to meet our outstanding short-term and long-term needs. Liquidity management is both a daily and long-term responsibility of management. We adjust our investments in liquid assets based upon management's assessment of expected loan demand, expected deposit flows, yields available on interest-earning deposits and investment securities, and the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest-earning overnight deposits and federal funds sold. If we require funds beyond our ability to generate them internally, we have additional borrowing capacity with the Federal Home Loan Bank of Atlanta. At June 30, 2014, we had an available borrowing limit of \$39.5 million in advances from the Federal Home Loan Bank of Atlanta.

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We are subject to various regulatory capital requirements " New Capital Rules, " Holding Company Regulation Capital". At June 30, 2014, we were in compliance with all applicable capital requirements. Beginning in 2015, we will be subject to additional capital requirements under capital regulations recently adopted by our regulators. See "Supervision and Regulation Federal Banking Regulation Capital Requirements" and Note 12 of the Notes to our Consolidated Financial Statements.

**Common Stock Dividend Policy.** The Company paid a quarterly \$0.10 per share dividend on August 29, 2013, November 21, 2013, February 27, 2014, and May 22, 2014 for a total of \$2.2 million in dividends paid during the year ended June 30, 2014. On July 24, 2014, the Board of Directors of the Company declared a quarterly cash dividend of \$0.10 per share of the Company's common stock payable to stockholders of record as of August 7, 2014, which was paid on August 21, 2014.

**Off-Balance Sheet Arrangements.** In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, are not recorded in our consolidated financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. For information about our loan commitments and unused lines of credit, see Note 11 of the Notes to our Consolidated Financial Statements.

For the fiscal year ended June 30, 2014, we did not engage in any off-balance-sheet transactions other than loan origination commitments in the normal course of our lending activities.

**Recent Accounting Pronouncements**

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

**Impact of Inflation and Changing Prices**

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

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

Quantitative and qualitative disclosures about market risk are not required for smaller reporting companies, such as the Company.

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**ITEM 8. *Financial Statements and Supplementary Data***

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Oconee Federal Financial Corp.  
Seneca, South Carolina

We have audited the accompanying consolidated balance sheets of Oconee Federal Financial Corp. and Subsidiary (the "Company") as of June 30, 2014 and 2013, and the related consolidated statements of income and comprehensive income, changes in shareholders' equity and cash flows for each of the years then ended. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oconee Federal Financial Corp. and Subsidiary as of June 30, 2014 and 2013, and the results of their operations and their cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Cherry Bekaert LLP  
Greenville, South Carolina  
September 29, 2014



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****CONSOLIDATED BALANCE SHEETS****JUNE 30, 2014 AND 2013****(Amounts in thousands, except share and per share data)**

	<b>June 30, 2014</b>	<b>June 30, 2013</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 1,365	\$ 1,362
Interest-bearing deposits	10,525	36,580
Total cash and cash equivalents	11,890	37,942
Securities held-to-maturity (fair value: June 30, 2013 \$8,223)		8,039
Securities available-for-sale	103,806	87,985
Loans, net	229,931	221,163
Premises and equipment, net	2,993	3,047
Real estate owned, net	744	1,047
Accrued interest receivable		
Loans	811	863
Investments	251	269
Restricted equity securities	325	449
Bank owned life insurance	8,758	8,450
Other assets	992	841
Total assets	\$ 360,501	\$ 370,095
<b>LIABILITIES</b>		
Deposits		
Non-interest bearing	7,075	5,166
Interest bearing	273,940	287,256
Total deposits	281,015	292,422
Accrued interest payable and other liabilities	2,505	1,511
Total liabilities	283,520	293,933
<b>SHAREHOLDERS' EQUITY</b>		
Common stock, \$0.01 par value, 100,000,000 shares authorized; 5,834,395 and 5,923,295 shares outstanding	64	64
Treasury stock, at par 600,699 and 511,799 shares	(6)	(5)
Additional paid-in capital	12,186	13,413
Retained earnings	66,705	65,315
Accumulated other comprehensive loss	(147)	(559)
Unearned ESOP shares	(1,821)	(2,066)
Total shareholders' equity	76,981	76,162

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Total liabilities and shareholders' equity	\$ 360,501	\$ 370,095
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See accompanying notes to consolidated financial statements

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013****(Amounts in thousands, except share and per share data)**

	June 30, 2014	June 30, 2013
<b>Interest and dividend income:</b>		
Loans, including fees	\$ 11,365	\$ 12,749
Securities, taxable	1,535	1,170
Securities, tax-exempt	22	
Federal funds sold and other	54	73
Total interest income	12,976	13,992
<b>Interest expense:</b>		
Deposits	1,480	2,174
Total interest expense	1,480	2,174
Net interest income	11,496	11,818
Provision for loan losses	108	260
Net interest income after provision for loan losses	11,388	11,558
<b>Noninterest income:</b>		
Service charges on deposit accounts	76	80
Income on bank owned life insurance	307	65
Gain on sales of securities	234	133
Gain (loss) on sales of real estate owned	(11)	65
Other	2	67
Total noninterest income	608	410
<b>Noninterest expense:</b>		
Salaries and employee benefits	3,629	3,368
Occupancy and equipment	664	651
Data processing	264	253
Professional and supervisory fees	773	435
Office expense	136	134
Advertising	74	68
FDIC deposit insurance	157	117
Charitable contributions		2
Provision for real estate owned and related expenses	259	142

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Other	351	326
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Total noninterest expense	6,307	5,496
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Income before income taxes	5,689	6,472
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Income tax expense	2,050	2,432
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Net income	\$ 3,639	\$ 4,040
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Other comprehensive income (loss)

Unrealized (loss) gain on securities available-for-sale	\$ 851	\$ (1,731)
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Tax effect	(324)	655
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Reclassification adjustment for gains realized in net income	(234)	(133)
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Tax effect	91	51
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Total other comprehensive income (loss)	384	(1,158)
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Comprehensive income	\$ 4,023	\$ 2,882
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Basic net income per share (Note 2)	\$ 0.64	\$ 0.67
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Diluted net income per share (Note 2)	\$ 0.64	\$ 0.67
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Dividends declared per share	\$ 0.40	\$ 0.40
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See accompanying notes to consolidated financial statements

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	Common Stock	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance at June 30, 2012	\$ 64	\$	\$ 20,880	\$ 63,693	\$ 599	\$ (2,252)	\$ 82,984
Net income				4,040			4,040
Other comprehensive loss					(1,158)		(1,158)
Purchase of 500,350 shares of treasury stock		(5)	(7,772)				(7,777)
Stock-based compensation expense			227				227
Dividends				(2,418)			(2,418)
ESOP shares earned			78			186	264
Balance at June 30, 2013	\$ 64	\$ (5)	\$ 13,413	\$ 65,315	\$ (559)	\$ (2,066)	\$ 76,162
Net income				3,639			3,639
Other comprehensive income					384		384
Transfers of securities from classified as held-to-maturity to available-for-sale, net of tax of \$17					28		28
Purchase of 99,070 shares of treasury stock(1)		(1)	(1,625)				(1,626)
Issuance of 12,600 shares of restricted stock(2)							
Stock-based compensation expense			248				248
Dividends(3)(4)				(2,236)			(2,236)
ESOP shares earned(4)			150	(13)		245	382
Balance at June 30, 2014	\$ 64	\$ (6)	\$ 12,186	\$ 66,705	\$ (147)	\$ (1,821)	\$ 76,981

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- (1) The weighted average cost of treasury shares purchased during the year ended was \$17.70 per share. Treasury stock repurchases were accounted for using the par value method.
- (2) On November 13, 2013, the Company granted 12,600 shares of restricted stock. The grant date fair value of these shares was \$17.16.
- (3) Cash dividends declared on July 25, 2013 were paid on August 29, 2013. Cash dividends declared on October 24, 2013 were paid on November 21, 2013. Cash dividends declared on January 30, 2014 were paid on February 27, 2014. Cash dividends declared on April 24, 2014 were paid on May 22, 2014.

(4)

Approximately \$99 of cash dividends paid on shares in the ESOP was used as additional principal reduction on the ESOP debt, resulting in the release of approximately 8,000 additional shares. The portion of the dividend paid on allocated shares of approximately \$13 was treated as a dividend. The remaining portion of the dividend payment and resulting release of approximately 7,000 shares was accounted for as additional compensation expense of approximately \$63 for the year ended June 30, 2014.

See accompanying notes to consolidated financial statements

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED JUNE 30, 2014 AND 2013****(Amounts in thousands, except share and per share data)**

	<b>June 30, 2014</b>	<b>June 30, 2013</b>
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 3,639	\$ 4,040
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	108	260
Provision for real estate owned	164	23
Depreciation and amortization, net	907	1,154
Deferred loan fees, net	33	(325)
Deferred income tax expense	(362)	165
Gain on loan foreclosures		(65)
(Gain) loss on sales of real estate owned	11	(65)
Gain on sales of securities	(234)	(133)
Increase in cash surrender value of bank owned life insurance	(307)	(65)
ESOP compensation expense	382	264
Stock based compensation expense	248	227
Net change in operating assets and liabilities:		
Accrued interest receivable	70	51
Accrued interest payable	(2)	(19)
Other	(193)	697
Net cash provided by operating activities	4,464	6,209
<b>Cash Flows From Investing Activities</b>		
Purchases of premises and equipment	(152)	(70)
Purchases of securities held-to-maturity	(3,486)	(1,992)
Purchases of securities available-for-sale	(37,924)	(45,925)
Proceeds from maturities, paydowns and calls of securities available-for-sale	13,981	11,611
Proceeds from maturities, paydowns and calls of securities held-to-maturity		2,631
Proceeds from sales of securities available-for-sale	18,721	8,245
Proceeds from sales of securities held-to-maturity	2,270	
Redemptions of restricted equity securities	124	115
Purchase of bank owned life insurance		(8,000)
Proceeds from sale of real estate owned	196	1,300
Loan originations and repayments, net	(8,977)	27,347
Net cash used in investing activities	(15,247)	(4,738)
<b>Cash Flows from Financing Activities</b>		
Net change in deposits	(11,407)	(946)
Dividends paid	(2,236)	(2,418)
Purchase of treasury stock	(1,626)	(7,777)

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Net cash used in financing activities	(15,269)	(11,141)
Change in cash and cash equivalents	(26,052)	(9,670)
Cash and cash equivalents, beginning of year	37,942	47,612
Cash and cash equivalents, end of year	\$ 11,890	\$ 37,942

See accompanying notes to consolidated financial statements



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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**As of and for the Years Ended June 30, 2014 and 2013**

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

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Nature of Operations and Principle of Consolidation:* The consolidated financial statements of Oconee Federal Financial Corp. include the accounts of its wholly owned subsidiary Oconee Federal Savings and Loan Association (the "Association") (referred to herein as "the Company") and have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). Intercompany accounts and transactions are eliminated during consolidation. The Company is majority owned (70.7%) by Oconee Federal, MHC. These consolidated financial statements do not include the transactions and balances of Oconee Federal, MHC. The Association is a federally chartered stock savings and loan association engaged in the business of accepting savings and demand deposits and providing mortgage, consumer and commercial loans. Primarily, the Association's business is limited to the Oconee County area of northwestern South Carolina. The following is a description of the significant accounting policies the Company follows in preparing and presenting its consolidated financial statements.

*Use of Estimates:* To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses, real estate owned, carrying value of deferred tax assets and fair value of financial instruments are particularly subject to change.

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

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

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

*Securities:* Securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available-for-sale when they might be sold before maturity. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

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

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation.

*Loans:* Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance.

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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**As of and for the Years Ended June 30, 2014 and 2013**

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

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Management defers any material loan fees net of certain direct costs and amortizes these deferred fees or costs into interest income using the level yield method over the contractual lives of the loans without anticipating prepayments.

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

Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Company's policy, typically after 90 days of non-payment.

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

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

Management utilizes an internal loan grading system and assigns each loan a grade of pass, special mention, substandard, or doubtful, which are more fully explained in Note 4. Any nonresidential or residential non-owner occupied loans that meet certain size requirements and performance characteristics are individually evaluated for impairment. In addition, all nonperforming and any associated loans of the same borrower and loans approved for foreclosure are individually evaluated for impairment regardless of size. The amount of impairment, if any, is measured by a comparison of the loan's carrying value to the net present value of future cash flows using the loan's effective rate at inception or at the fair value of collateral if repayment is expected to come solely from the collateral. All loans graded pass, special mention, substandard and doubtful not specifically evaluated for impairment are collectively evaluated for impairment by portfolio segment. To develop and document a

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

systematic methodology for determining the portion of the allowance for loan losses for loans evaluated collectively, the Company has divided the loan portfolio into six portfolio segments, each with different risk characteristics and methodologies for assessing risk. Those portfolio segments are discussed below:

**One-to-four family:** One-to-four family residential loans consist primarily of loans secured by first or second deeds of trust on primary residences, and are originated as adjustable-rate or fixed-rate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. We currently originate residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes.

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

We also originate residential mortgage loans with loan-to-value ratios of up to 75% for manufactured or modular homes. We require lower loan-to-value ratios for manufactured and modular homes because such homes tend to depreciate over time. Manufactured or modular homes must be permanently affixed to a lot to make them more difficult to move without our permission. Such homes must be "de-titled" by the State of South Carolina so that they are taxed and must be transferred as residential homes rather than vehicles. We also obtain a mortgage on the real estate to which such homes are affixed. Loans for manufactured or modular homes represent less than 2% of our portfolio of one-to-four family loans.

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

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

**Home Equity:** We originate fixed-rate home equity loans secured by a lien on the borrower's primary residence but only where we hold the first mortgage on the property. Our home equity loans

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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

are limited to an 80% loan-to-value ratio (including all prior liens), and have terms of up to 10 years with 10-year amortization periods. We use the same underwriting standards for home equity loans as we use for one-to-four family residential mortgage loans.

**Nonresidential Real Estate:** Our non-residential real estate loans are secured primarily by churches and, to a much lesser extent, office buildings, and retail and mixed-use properties located in our primary market area. The non-residential real estate loans that we originate generally have maximum terms of 5 years with amortization periods of 30 years. For loans secured by church property, our loans generally have maximum terms of 20 years with amortization periods of up to 20 years. The maximum loan-to-value ratio of our non-residential real estate loans is generally 75%.

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

Loans secured by non-residential real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Non-residential real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including the current adverse conditions. In addition, because a church's financial stability often depends on donations from congregation members, some of whom may not reside in our market area, rather than income from business operations, repayment may be affected by economic conditions that affect individuals located both in our market area and in other market areas with which we are not as familiar. In addition, due to the unique nature of church buildings and properties, the real estate securing church loans may be less marketable than other non-residential real estate.

**Construction and Land:** We make construction loans to individuals for the construction of their primary residences. These loans generally have maximum terms of eight months, and upon completion of construction convert to conventional amortizing mortgage loans. These construction loans have rates and terms comparable to one-to-four family residential mortgage loans that we originate. During the construction phase, the borrower generally pays interest only. The maximum loan-to-value ratio of our

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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**As of and for the Years Ended June 30, 2014 and 2013**

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

owner-occupied construction loans is 80%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential mortgage loans.

We also make interim construction loans for non-residential properties. In addition, we occasionally make loans for the construction of homes "on speculation," but we generally permit a borrower to have only one such loan at a time. These loans generally have a maximum term of eight months, and upon completion of construction convert to conventional amortizing non-residential real estate loans. These construction loans have rates and terms comparable to permanent loans secured by property of the type being constructed that we originate. The maximum loan-to-value ratio of these construction loans is 80%.

Finally, we make loans secured by land to complement our construction and non-residential lending activities. These loans have terms of up to 10 years, and maximum loan-to-value ratios of 75% for improved lots and 65% for unimproved land.

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

**Consumer and Other Loans:** We offer installment loans for various consumer purposes, including the purchase of automobiles, boats, appliances and recreational vehicles, and for other legitimate personal purposes. The maximum terms of consumer loans is 18 months for unsecured loans, 12 months for loans secured by marketable securities and 18-60 months for loans secured by a vehicle, depending on the age of the vehicle. We generally only extend consumer loans to existing customers or their immediate family members, and these loans generally have relatively low limits.

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

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

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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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

*Premises and equipment:* Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 39 years. Furniture, fixtures and equipment are depreciated using the straight-line method, with useful lives ranging from 5 to 7 years. Maintenance and repairs are charged to operations in the year incurred. Gains and losses on dispositions are included in current year operations.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. If the sum of the expected cash flows is less than the stated amount of the asset, an impairment loss is recognized.

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

Fair values are based primarily on independent appraisals. Recovery of estimated fair value is dependent to a great extent on economic, operating, and other conditions that may be beyond the Company's control. Accordingly, these estimates are particularly susceptible to changes that could result in material adjustments in the near term.

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

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

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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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

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

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

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

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

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

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

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

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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**As of and for the Years Ended June 30, 2014 and 2013**

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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

*Reclassifications:* Some items in the prior year consolidated financial statements were reclassified to conform to the current presentation.

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

*New accounting standards:*

In May 2014, the FASB issued ASU 2014-9 "*Revenue from Contracts with Customers (Topic 606)*". This guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. The adoption of this ASU will not have a material impact on the Company's consolidated financial statements.

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This ASU requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g. the release due to cash flow hedges from interest rate contracts) and the income statement line items affected by the reclassification (e.g., interest income or interest expense). If a component is not required to be reclassified to net income in its entirety, companies would instead cross reference to the related footnote for additional information. This ASU is effective for fiscal and interim reporting periods beginning after December 15, 2013. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.



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

	<b>Year Ended</b>	
	<b>June 30, 2014</b>	<b>June 30, 2013</b>
Earnings per share		
Net income	\$ 3,639	\$ 4,040
Less: distributed earnings allocated to participating securities	(26)	(21)
Less: (undistributed income) dividends in excess of earnings allocated to participating securities	(16)	(25)
<b>Net earnings available to common shareholders</b>	<b>\$ 3,597</b>	<b>\$ 3,994</b>
Weighted average common shares outstanding including participating securities	5,842,460	6,251,404
Less: participating securities	(67,699)	(71,095)
Less: average unearned ESOP shares	(194,022)	(215,774)
<b>Weighted average common shares outstanding</b>	<b>5,580,739</b>	<b>5,964,535</b>
Basic earnings per share	\$ 0.64	\$ 0.67
Weighted average common shares outstanding	5,580,739	5,964,535
Add: dilutive effects of assumed exercises of stock options	53,082	30,562
<b>Average shares and dilutive potential common shares</b>	<b>5,633,821</b>	<b>5,995,097</b>

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Diluted earnings per share	\$	0.64	\$	0.67
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During the year ended June 30, 2014, there were 7,700 shares that were potentially anti-dilutive. During the year ended June 30, 2013, there were no potential anti-dilutive common shares.

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 3 SECURITIES AVAILABLE-FOR-SALE AND HELD-TO-MATURITY**

Debt, mortgage-backed and equity securities have been classified in the consolidated balance sheets according to management's intent. Investment securities at June 30, 2014 and 2013 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>June 30, 2014</b>				
Available-for-sale:				
FHLMC common stock	\$ 20	\$ 294	\$	\$ 314
Preferred stock(1)	271	27		298
Certificates of deposit	7,221	24	(8)	7,237
Municipal securities	5,846	2	(39)	5,809
U.S. Government agency mortgage-backed securities	60,742	428	(730)	60,440
U.S. Government agency bonds	29,946	181	(419)	29,708
<b>Total available-for-sale</b>	<b>\$ 104,046</b>	<b>\$ 956</b>	<b>\$ (1,196)</b>	<b>\$ 103,806</b>

**June 30, 2013**

Held-to-maturity:				
Certificates of deposit	\$ 3,985	\$ 18	\$ (13)	\$ 3,990
U.S. Government agency mortgage-backed securities	4,054	179		4,233
<b>Total held-to-maturity</b>	<b>\$ 8,039</b>	<b>\$ 197</b>	<b>\$ (13)</b>	<b>\$ 8,223</b>

Available-for-sale:				
FHLMC common stock	\$ 20	\$ 90	\$	\$ 110
Preferred stock(1)	271	26		297
U.S. Government agency mortgage-backed securities	50,209	184	(866)	49,527
U.S. Government agency bonds	38,387	294	(630)	38,051
<b>Total available-for-sale</b>	<b>\$ 88,887</b>	<b>\$ 594</b>	<b>\$ (1,496)</b>	<b>\$ 87,985</b>

(1)

Consists of 300 shares of Southern First Bancshares, Inc. cumulative perpetual preferred stock, series T.

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	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
<b>June 30, 2014</b>						
Available for Sale:						
Certificates of deposit	\$ 1,237	\$ (8)	\$	\$	\$ 1,237	\$ (8)
Municipal securities	4,263	(39)			4,263	(39)
U.S. Government agency mortgage-backed securities	7,241	(24)	21,464	(706)	28,705	(730)
U.S. Government agency bonds	3,467	(5)	12,574	(414)	16,041	(419)
	\$ 16,208	\$ (76)	\$ 34,038	\$ (1,120)	\$ 50,246	\$ (1,196)

In the above table, there were eleven U.S. Government agency securities with unrealized losses, eight of which were for twelve months or more, eleven municipal securities, with zero for twelve months or more, twenty-four U.S. Government agency mortgage-backed securities, with eighteen for twelve months or more, and five certificates of deposit securities, with zero for twelve months or more at June 30, 2014. None of the unrealized losses for these securities have been recognized into net income for the year ended June 30, 2014 because the issuer's bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the bonds approach their maturity date or reset date. None of the unrealized losses on investment securities at June 30, 2013 were recognized into income as OTTI losses during 2014.

At June 30, 2013, there were fourteen U.S. Government agency securities, four GNMA CMO/REMIC securities, two FNMA CMO/REMIC securities, two FHLMC CMO/REMIC securities, seven FHLMC mortgage-backed securities, six FNMA mortgage-backed securities, two GNMA mortgage-backed securities, and five certificates of deposit securities with unrealized losses at June 30, 2013. None of the unrealized losses for these securities have been recognized into net income for the year ended June 30, 2013 because the issuer's bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value is expected to recover as the bonds approach their maturity date or reset date. All of the investments with unrealized losses had been in an unrealized loss position for less than 12 months at June 30, 2013.

The Company evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company considers the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. Additionally, the Company considers its intent to sell or whether it will be more likely than not it will be required to sell the security prior to the security's anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are

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issued by the federal Government agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

The amortized cost and fair value of securities available-for-sale and held-to-maturity debt securities at June 30, 2014 and 2013, by contractual maturity, are summarized as follows:

	June 30, 2014		June 30, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less than one year	\$ 4,002	\$ 4,029	\$ 996	\$ 997
Due from one to five years	18,717	18,836	26,178	26,437
Due from five to ten years	13,297	13,047	11,198	10,800
Due after ten years	6,997	6,842	4,000	3,807
Mortgage-backed securities	60,742	60,440	54,263	53,760
Total	\$ 103,755	\$ 103,194	\$ 96,635	\$ 95,801

Sales of securities available-for-sale during the years ended June 30, 2014 and 2013 securities were as follows:

	June 30, 2014	June 30, 2013
<b>Available for Sale:</b>		
Proceeds	\$ 18,721	\$ 8,245
Gross gains	182	133
Gross losses	(30)	
<b>Held-to-maturity:</b>		
Proceeds	\$ 2,270	\$
Gross gains	82	
Gross losses		
<b>Total:</b>		
Proceeds	\$ 20,991	\$ 8,245

Gross gains	\$ 264	\$ 133
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Gross losses \$ (30) \$

During the year ended June 30, 2014, the Company sold two securities classified as held-to-maturity. One of those securities was a GNMA mortgage-backed security for which at least 85 percent of its original principal amount had been repaid. The second security was also a GNMA mortgage-backed security. Because the Company determined that it no longer had the positive intent to hold its investment in securities classified as held-to-maturity for an indefinite period of time because of the Company's desire to have more flexibility in managing the investment portfolio, all of the Company's securities classified as held-to-maturity were transferred to the available-for-sale category. The securities transferred had a total amortized cost of \$7.8 million, with unrealized gross gains of \$56

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 3 SECURITIES AVAILABLE-FOR-SALE AND HELD-TO-MATURITY (Continued)**

and unrealized gross losses of \$11 at the time of transfer. The net unrealized gain of \$45 was added to other comprehensive income at the time of transfer.

**NOTE 4 LOANS**

Loans at June 30, 2014 and 2013 are as follows:

	<b>June 30, 2014</b>	<b>June 30, 2013</b>
Real estate loans:		
One-to-four family	\$ 214,735	\$ 204,397
Multi-family	254	258
Home equity	227	292
Nonresidential	8,408	8,521
Construction and land	7,661	8,735
<b>Total real estate loans</b>	<b>231,285</b>	<b>222,203</b>
Consumer and other loans	747	925
<b>Total loans</b>	<b>232,032</b>	<b>223,128</b>
Net deferred loan fees	(1,246)	(1,214)
Allowance for loan losses	(855)	(751)
Loans, net	\$ 229,931	\$ 221,163



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of and for the Years Ended June 30, 2014 and 2013

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

**NOTE 4 LOANS (Continued)**

The following tables present the activity in the allowance for loan losses for the years ended June 30, 2014 and 2013 and the balances of the allowance for loan losses and recorded investment in loans by portfolio class based on impairment method at June 30, 2014 and 2013:

	Real estate							Total
	One-to-four family	Multi-family	Home Equity	Nonresidential	Construction and land	Consumer		
<b>June 30, 2014</b>								
Beginning balance	\$ 665	\$ 4	\$ 1	\$ 52	\$ 27	\$ 2	\$	751
Provision	75				32	1		108
Charge-offs	(4)							(4)
Recoveries								
Ending balance	\$ 736	\$ 4	\$ 1	\$ 52	\$ 59	\$ 3	\$	855

**Allowance for loan losses:**

Ending allowance attributed to loans:

Individually evaluated for impairment	\$ 52	\$	\$	\$	\$	\$	\$	52
Collectively evaluated for impairment	684	4	1	52	59	3		803

**Total ending allowance**

balance	\$ 736	\$ 4	\$ 1	\$ 52	\$ 59	\$ 3	\$	855
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**Loans:**

Loans individually evaluated for impairment	\$ 1,647	\$	\$	\$	\$	\$	\$	1,647
Loans collectively evaluated for impairment	213,088	254	227	8,408	7,661	747		230,385

<b>Total ending loans balance</b>	<b>\$ 214,735</b>	<b>\$ 254</b>	<b>\$ 227</b>	<b>\$ 8,408</b>	<b>\$ 7,661</b>	<b>\$ 747</b>	<b>\$</b>	<b>232,032</b>
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## OCONEE FEDERAL FINANCIAL CORP.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the Years Ended June 30, 2014 and 2013

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

## NOTE 4 LOANS (Continued)

	Real estate							Total
	One-to-four family	Multi-family	Home Equity	Nonresidential	Construction and land	Consumer		
<b>June 30, 2013</b>								
Beginning balance	\$ 773	\$ 4	\$ 1	\$ 56	\$ 21	\$ 2		\$ 857
Provision	258			(4)	6			260
Charge-offs	(366)							(366)
Recoveries								
Ending balance	\$ 665	\$ 4	\$ 1	\$ 52	\$ 27	\$ 2		\$ 751

**Allowance for loan losses:**

Ending allowance attributed to loans:

Individually evaluated for impairment	\$ 27	\$	\$	\$	\$	\$		\$ 27
Collectively evaluated for impairment	638	4	1	52	27	2		724
Total ending allowance balance	\$ 665	\$ 4	\$ 1	\$ 52	\$ 27	\$ 2		\$ 751

**Loans:**

Loans individually evaluated for impairment	\$ 1,986	\$	\$	\$	\$	\$		\$ 1,986
Loans collectively evaluated for impairment	202,411	258	292	8,521	8,735	925		221,142
Total ending loans balance	\$ 204,397	\$ 258	\$ 292	\$ 8,521	\$ 8,735	\$ 925		\$ 223,128



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 4 LOANS (Continued)**

The following table presents loans individually evaluated for impairment by portfolio class at June 30, 2014 and 2013, including the average recorded investment balance and interest earned for the years ended June 30, 2014 and 2013:

	June 30, 2014					June 30, 2013				
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Recognized	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Recognized
<b>With no recorded allowance:</b>										
Real estate loans:										
One-to-four family	\$ 374	\$ 374	\$	1,054	\$ 8	\$ 1,734	\$ 1,734	\$	1,202	\$ 27
Multi-family										
Home equity										
Nonresidential										
Construction and land										
Total real estate loans	374	374		1,054	8	1,734	1,734		1,202	27
Consumer and other loans										
Total	\$ 374	\$ 374	\$	1,054	\$ 8	\$ 1,734	\$ 1,734	\$	1,202	\$ 27
<b>With recorded allowance:</b>										
Real estate loans:										
One-to-four family	\$ 1,273	\$ 1,273	\$ 52	763	\$ 9	\$ 252	\$ 252	\$ 27	1,033	\$ 6
Multi-family										
Home equity										
Nonresidential										
Construction and land										
Total real estate loans	1,273	1,273	52	763	9	252	252	27	1,033	6
Consumer and other loans										
Total	\$ 1,273	\$ 1,273	\$ 52	763	\$ 9	\$ 252	\$ 252	\$ 27	1,033	\$ 6

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<b>Totals:</b>																				
Real estate loans	\$	1,647	\$	1,647	\$	52	\$	1,817	\$	17	\$	1,986	\$	1,986	\$	27	\$	2,235	\$	33
Consumer and other loans																				
<b>Total</b>	<b>\$</b>	<b>1,647</b>	<b>\$</b>	<b>1,647</b>	<b>\$</b>	<b>52</b>	<b>\$</b>	<b>1,817</b>	<b>\$</b>	<b>17</b>	<b>\$</b>	<b>1,986</b>	<b>\$</b>	<b>1,986</b>	<b>\$</b>	<b>27</b>	<b>\$</b>	<b>2,235</b>	<b>\$</b>	<b>33</b>

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## OCONEE FEDERAL FINANCIAL CORP.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of and for the Years Ended June 30, 2014 and 2013

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

## NOTE 4 LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans at June 30, 2014 and 2013 by portfolio class of loans:

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Accruing Loans Past Due 90 Days or More
<b>June 30, 2014</b>							
Real estate loans:							
One-to-four family	\$ 4,856	\$ 893	\$ 1,053	\$ 6,802	\$ 207,933	\$ 214,735	\$
Multi-family					254	254	
Home equity					227	227	
Nonresidential	87			87	8,321	8,408	
Construction and land					7,661	7,661	
Total real estate loans	4,943	893	1,053	6,889	224,396	231,285	
Consumer and other loans					747	747	
Total	\$ 4,943	\$ 893	\$ 1,053	\$ 6,889	\$ 225,143	\$ 232,032	\$

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Accruing Loans Past Due 90 Days or More
<b>June 30, 2013</b>							
Real estate loans:							
One-to-four family	\$ 5,932	\$ 2,397	\$ 1,726	\$ 10,055	\$ 194,342	\$ 204,397	\$ 493
Multi-family					258	258	
Home equity	30			30	262	292	
Nonresidential					8,521	8,521	
Construction and land					8,735	8,735	
Total real estate loans	5,962	2,397	1,726	10,085	212,118	222,203	493
Consumer and other loans	1			1	924	925	

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Total	\$	5,963	\$	2,397	\$	1,726	\$	10,086	\$	213,042	\$	223,128	\$	493
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Nonaccrual loans at June 30, 2014 and June 30, 2013 were \$1,647 and \$1,493, respectively. All of these loans are disclosed by portfolio segment above in the "90 days or more past due" column at June 30, 2014, except one loan in the "60-89 days past due" category with a carrying amount of \$220 and one loan in the "30-59 days past due" category with a carrying amount of \$374. All nonaccrual loans at June 30, 2013 were disclosed in the 90 days or more past due column. Non-performing loans and loans past due 90 days and still accruing include both smaller balance homogenous loans that are collectively evaluated for impairment and individually classified as impaired loans. There were no TDRs at June 30, 2014 or 2013.

The Company utilizes a grading system whereby all loans are assigned a grade based on the risk profile of each loan. Loan grades are determined based on an evaluation of relevant information about the ability of borrowers to service their debt such as current financial information, historical payment



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 4 LOANS (Continued)**

experience, credit documentation, public information, and current economic trends, among other factors. All loans, regardless of size, are analyzed and are given a grade based upon the management's assessment of the ability of borrowers to service their debts.

The Company uses the following definitions for loan grades:

**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of repayment prospects for the loan or of the institution's credit position at some future date.

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

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

Loans not meeting the criteria above are graded Pass. These loans are included within groups of homogenous pools of loans based upon portfolio segment and class for estimation of the allowance for loan losses on a collective basis. Loans graded special mention through substandard are individually evaluated for impairment, regardless of size.

Loan risk ratings in the table above were updated for the year ended June 30, 2014 and 2013.

Loans to principal officers, directors, and their affiliates during the years ended June 30, 2014 and 2013 were as follows:

	<b>June 30, 2014</b>	<b>June 30, 2013</b>
Beginning balance	\$ 788	\$ 812
New loans		
Repayments	(22)	(24)

Ending balance	\$ 766	\$ 788
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Directors and officers of the Company are customers of the institution in the ordinary course of business. Loans to directors and executive officers have terms consistent with those offered to other customers. In the opinion of management, these loans do not involve more than normal risk of collectability nor do they present other unfavorable features.



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 5 PREMISES AND EQUIPMENT**

Premises and equipment at June 30, 2014 and 2013 were as follows:

	<b>June 30, 2014</b>	<b>June 30, 2013</b>
Land	\$ 783	\$ 783
Buildings and improvements	4,644	4,568
Furniture, fixtures and equipment	1,400	1,324
	6,827	6,675
Less: accumulated depreciation	(3,834)	(3,628)
	<b>\$ 2,993</b>	<b>\$ 3,047</b>

Depreciation expense was \$206 and \$206 for the years ended June 30, 2014 and 2013, respectively.

**NOTE 6 DEPOSITS**

At June 30, 2014 and 2013, deposit accounts with balances over \$100 totaled approximately \$64,485 and \$83,862, respectively. Scheduled maturities of certificates of deposit at June 30, 2014 for the next three years are as follows:

	<b>June 30, 2014</b>
2015	\$ 192,039
2016	6,681
2017	1,557
	<b>\$ 200,277</b>

There are no certificates of deposit scheduled to mature after 2017. The Company does not take brokered certificates of deposit.

Directors and executive officers were customers of and had transactions with the Company in the ordinary course of business. Included in such transactions are deposit accounts, all of which were made under normal terms. The aggregate amount of these deposit accounts was \$1,848 and \$2,129 at June 30, 2014 and 2013, respectively.

**NOTE 7 BORROWING ARRANGEMENTS WITH THE FEDERAL HOME LOAN BANK**

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The Company has credit available under a loan agreement with the FHLB in the amount of 11% of total assets (as defined), approximately \$39,520 of availability at June 30, 2014. As a member of the FHLB, the Company is required to own capital stock in the FHLB and is authorized to apply for advances from the FHLB. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range in maturities. Borrowings under the FHLB would mostly be secured by single family first mortgage loans. The Company had no advances from the FHLB as of June 30, 2014 and 2013 and recognized no interest expense for the respective years then ended.

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Income tax expense for the years ended June 30, 2014 and 2013 was as follows:

	June 30, 2014	June 30, 2013
Current federal expense	\$ 2,023	\$ 1,919
Current state expense	389	348
Deferred federal expense (benefit)	(305)	140
Deferred state expense (benefit)	(57)	25
<b>Total</b>	<b>\$ 2,050</b>	<b>\$ 2,432</b>

Temporary differences between tax and financial reporting that result in net deferred tax assets (liabilities) are as follows at June 30, 2014 and 2013:

	June 30, 2014	June 30, 2013
Deferred tax assets:		
Deferred compensation	\$ 295	\$ 306
Charitable contribution		
Allowance for loan losses	325	282
Securities available-for-sale	93	345
Other	337	(4)
<b>Total deferred tax assets</b>	<b>1,050</b>	<b>929</b>
Deferred tax liabilities:		
FHLB stock dividends	(82)	(81)
Deferred loan fees, net	(251)	(265)
Basis difference in premises and equipment	(67)	(43)
<b>Total deferred tax liabilities</b>	<b>(400)</b>	<b>(389)</b>
<b>Net deferred tax asset</b>	<b>\$ 650</b>	<b>\$ 540</b>

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Retained earnings as of June 30, 2014 and 2013 includes approximately \$5,284 representing reserve method bad debt reserves originating prior to December 31, 1987 for which no deferred income taxes are required to be provided. These reserves may be included in taxable income if the Company pays dividends in excess of its accumulated earnings and profits (as defined by the Internal Revenue Code) or in the event of a distribution in partial or complete liquidation of the Company.

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A reconciliation of the amount computed by applying the federal statutory rate (34%) to pretax income with income tax expense (benefit) for the years ended June 30, 2014 and 2013 is as follows:

	June 30, 2014		June 30, 2013	
	Amount	%	Amount	%
Tax at statutory federal income tax rate	\$ 1,937	34.00%	\$ 2,200	34.00%
Increase (decrease) resulting from:				
State income tax expense	219	3.84	247	3.75
Life insurance benefits	(105)	(1.84)	(22)	(0.34)
Tax exempt interest income	(6)	(0.11)		
Other net	5	0.08	7	0.11
<b>Total</b>	<b>\$ 2,050</b>	<b>35.97%</b>	<b>\$ 2,432</b>	<b>37.52%</b>

The Company does not have any uncertain tax positions and does not have any interest and penalties recorded in the consolidated statements of income and comprehensive income for the years ended June 30, 2014 and 2013. The Company is subject to U.S. federal income tax as well as income tax of the state of South Carolina. The Company is no longer subject to examination by taxing authorities for years before 2011.

**NOTE 9 EMPLOYEE BENEFIT PLANS**

The Company has deferred compensation agreements with certain of its directors whereby director fees are withheld to fund insurance contracts from which the funds will ultimately be disbursed. These agreements require the Company to make payments to such directors beginning at the age set forth in the agreement or upon death of the director if prior to the minimum age requirement. The directors vest ratably over periods established in the agreements. Interest on the liabilities is charged to earnings based on imputed interest rates established at the beginning of each agreement, which range from 6.69% to 8.05% at both June 30, 2014 and 2013, respectively. The total expense incurred under these plans for the years ended June 30, 2014 and 2013 was \$61 and \$46, respectively. The recorded liability for these agreements was \$775 and \$808 at June 30, 2014 and 2013, respectively, and is included in other accrued liabilities in the consolidated balance sheet.

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

The Company has the option of making an annual contribution to a profit-sharing plan for all full-time employees over the age of 21 having completed one year of service. The Company has exercised this option in 2014 and 2013, and as such, total expense under the profit sharing plan for each of the years ended June 30, 2014 and 2013 was \$64 and \$62, respectively.

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 10 EMPLOYEE STOCK OWNERSHIP PLAN ("ESOP")**

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

Participants receive the shares at the end of employment. During the year ended June 30, 2014, \$75 of discretionary contributions were made to the ESOP for debt retirement, which resulted in an additional \$91 of compensation expense. ESOP compensation expense recognized for the years ended June 30, 2014 and 2013 was \$382 and \$264, respectively.

Shares held by the ESOP at June 30, 2014 and 2013 were as follows:

	June 30, 2014	June 30, 2013
Committed to be released to participants	9,464	9,064
Allocated to participants	57,902	33,211
Unearned	181,476	206,567
Total ESOP shares	248,842	248,842

Fair value of unearned shares	\$ 3,277,457	\$ 3,059,257
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**NOTE 11 COMMITMENTS**

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

The contractual amount of financial instruments with off-balance-sheet risk at June 30, 2014 and 2013 was as follows:

	June 30, 2014		June 30, 2013	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	\$ 3,128	\$	\$ 1,056	\$

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments are primarily for the purpose of financing the purchase, the refinance, or the construction of residential real estate. At June 30, 2014, these commitments have interest rates ranging from 3.25% to 7.25% and maturities ranging from 15 to 30 years. At June 30, 2013, these commitments have interest rates ranging from 3.95% to 7.25% and maturities ranging from 10 to 30 years.





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

Leases and service agreements: The Company leases office equipment under varying lease terms, which are noncancelable. Rent expense was approximately \$64 and \$60 for the years ended June 30, 2014 and 2013, respectively. Future minimum lease commitments under the non-cancelable operating leases are as follows:

Year	Operating Lease	
2015	11	
2016	2	
<b>Total</b>	<b>\$ 13</b>	

The Company is obligated under a 7-year service agreement with a third party, which expires on January 31, 2016. The third party provides electronic transaction services related to the deposit and loan cycles for the Company. Transaction processing service expense related to this agreement for the years ended June 30, 2014 and 2013 was \$239 and \$244, respectively, and is included in data processing expenses on the consolidated statements of income and comprehensive income.

**NOTE 12 REGULATORY CAPITAL REQUIREMENTS**

Savings and loan associations are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. Management believes as of June 30, 2014, the Association met all capital adequacy requirements to which it is subject. Savings and loan holding companies will be subject to capital requirements beginning January 1, 2015.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At June 30, 2014 and 2013, the most recent regulatory notifications categorized the Association as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Association's category. The Association's

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 12 REGULATORY CAPITAL REQUIREMENTS (Continued)**

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

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>June 30, 2014</b>						
Total capital to risk weighted assets	\$ 71,669	42.31%	\$ 13,550	8.00%	\$ 16,938	10.00%
Tier 1 (core) capital to risk weighted assets	70,682	41.73	\$ 6,775	4.00	10,163	6.00
Tier 1 (core) capital to tangible assets	70,682	19.61	10,815	3.00	18,025	5.00
Tangible capital to tangible assets	70,682	19.61	5,408	1.50	N/A	N/A

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>June 30, 2013</b>						
Total capital to risk weighted assets	\$ 73,452	44.29%	\$ 13,267	8.00%	\$ 16,584	10.00%
Tier 1 (core) capital to risk weighted assets	72,686	43.83	6,634	4.00	9,950	6.00
Tier 1 (core) capital to tangible assets	72,686	19.62	11,113	3.00	18,522	5.00
Tangible capital to tangible assets	72,686	19.62	5,557	1.50	N/A	N/A

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

**Dividend Restrictions** The Company's principal source of funds for dividend payments is dividends received from the Association. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During 2014, the Association could, without prior approval, declare dividends of approximately \$3,822 (based on an annualized net income for the calendar year ending 2014).

**NOTE 13 FAIR VALUE MEASUREMENTS**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 13 FAIR VALUE MEASUREMENTS (Continued)**

There are three levels of inputs that may be used to measure fair values:

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

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

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

The fair values of securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

There were no transfers between Level 1 and Level 2 fair value measurements at June 30, 2014 and June 30, 2013.

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Nonrecurring adjustments to certain commercial and residential real estate properties classified as real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Assets and liabilities measured at fair value on a recurring basis at June 30, 2014 and 2013 are summarized below:

	<b>Fair Value Measurements</b>	
	<b>(Level 2) June 30, 2014</b>	<b>(Level 2) June 30, 2013</b>
<b>Financial assets:</b>		
Securities available-for-sale	\$ 103,806	\$ 87,985
<b>Total financial assets</b>	<b>\$ 103,806</b>	<b>\$ 87,985</b>



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 13 FAIR VALUE MEASUREMENTS (Continued)**

The table below presents assets measured at fair value on a non-recurring basis by level at June 30, 2014 and June 30, 2013:

	Fair Value Measurements	
	(Level 3) June 30, 2014	(Level 3) June 30, 2013
Financial assets:		
Impaired real estate loans, with specific allocations:		
One-to-four-family	\$ 1,221	\$ 225
Non-financial assets:		
Real estate owned, net:		
One-to-four-family	744	1,047
<b>Total non-financial assets</b>	<b>744</b>	<b>1,047</b>
<b>Total assets measured at fair value on a non-recurring basis</b>	<b>\$ 1,965</b>	<b>\$ 1,272</b>

The Company's impaired loans, which were measured for impairment using the fair value of collateral less costs to sell, had a carrying amount of \$1,221 and \$225 at June 30, 2014 and 2013, respectively. The carrying value included a valuation allowance of \$52 and \$27, respectively. The impact to the provision to loan losses from the change in the valuation allowances was an increase of \$25 and a decrease of \$33 for the years ended June 30, 2014 and 2013, respectively.

Real estate owned is carried at the lower of carrying value or fair value less costs to sell. The outstanding balances of real estate owned and their respective valuation allowances at June 30, 2014 and 2013 were \$744 and \$164 and \$1,047 and \$0, respectively.

The resulting write-downs for measuring real estate owned at the lower of carrying or fair value less costs to sell were \$164 and \$23 for the years ended June 30, 2014 and 2013, respectively.

[Table of Contents](#)**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 13 FAIR VALUE MEASUREMENTS (Continued)**

The table below presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at June 30, 2014:

<b>Level 3 Quantitative Information at June 30, 2014</b>				
	<b>Fair Value</b>	<b>Valuation Technique</b>	<b>Unobservable Inputs</b>	<b>Range (Weighted Average)</b>
<b>Impaired real estate loans net, with specific allocations:</b>				
One-to-four family	\$ 1,221	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 30% (15%)
<b>Real estate owned:</b>				
One-to-four family	\$ 744	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20% (10%)

<b>Level 3 Quantitative Information at June 30, 2013</b>				
	<b>Fair Value</b>	<b>Valuation Technique</b>	<b>Unobservable Inputs</b>	<b>Range (Weighted Average)</b>
<b>Impaired real estate loans net, with specific allocations:</b>				
One-to four-family	\$ 225	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 30% (15%)
<b>Real estate owned:</b>				
One-to four-family	\$ 1,047	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20% (10%)

The carrying amounts and estimated fair values of the Company's on-balance sheet financial instruments at June 30, 2014 and 2013 are summarized below:

**June 30, 2014**

	<b>Carrying Amount</b>	<b>Fair Value</b>			<b>Total</b>
		<b>(Level 1)</b>	<b>(Level 2)</b>	<b>(Level 3)</b>	
<b>Financial assets</b>					
Securities available-for-sale	\$ 103,806	\$	\$ 103,806	\$	\$ 103,806
Loans, net	229,931			233,176	233,176
Restricted equity securities(1)	325	N/A	N/A	N/A	N/A
<b>Financial liabilities</b>					

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Deposits

\$ 281,015 \$ 80,904 \$ 200,662 \$ 281,566  
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	Carrying Amount	Fair Value			Total
		(Level 1)	(Level 2)	(Level 3)	
<b>Financial assets</b>					
Securities available-for-sale	\$ 87,985	\$	\$ 87,985	\$	\$ 87,985
Securities held-to-maturity	8,039		8,223		8,223
Loans, net	221,163			229,745	229,745
Restricted equity securities(1)	449	N/A	N/A	N/A	N/A
<b>Financial liabilities</b>					
Deposits	\$ 292,422	\$ 74,471	\$ 218,395	\$	\$ 292,866

(1) It was not practicable to determine fair value of restricted equity securities due to restrictions placed on transferability.

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest bearing deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk (including consideration of widening credit spreads). It was not practicable to determine the fair value of restricted equity securities due to restrictions placed on transferability. The fair value of off-balance sheet items is not considered material (or is based on the current fees or cost that would be charged to enter into or terminate such arrangements).

**NOTE 14 STOCK BASED COMPENSATION**

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

On April 27, 2012, the compensation committee of the board of directors approved the issuance of 62,208 stock options to purchase Company stock and 24,884 shares of restricted stock to its directors. In addition, a total of 171,078 stock options and 62,210 shares of restricted stock were granted to officers. Stock options and restricted stock have vesting periods of 5 years or 7 years, a percentage of which vests annually on each anniversary date of grant. The weighted average vesting period of stock



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 14 STOCK BASED COMPENSATION (Continued)**

options and restricted stock granted was 5.7 years and 5.6 years, respectively. Stock options expire ten years after issuance. Apart from the vesting schedule for both stock options and restricted stock, there are no performance-based conditions or any other material conditions applicable to the awards issued.

On November 13, 2013, the compensation committee of the board of directors approved the issuance of 7,700 stock options to purchase Company stock and 12,600 shares of restricted stock to one of the Company's officers. Stock options and restricted stock have vesting periods of 7 years, a percentage of which vests annually at each anniversary date of grant. Stock options expire ten years after issuance. Apart from the vesting schedule for both stock options and restricted stock, there are no performance-based conditions or any other material conditions applicable to the awards issued.

The following table summarizes stock option activity for the year ended June 30, 2014:

	Options	Weighted-Average Exercise Price/Share	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value(1)
Outstanding July 1, 2013	233,286	\$ 11.58		
Granted	7,700	17.16		
Exercised				
Forfeited				
Outstanding June 30, 2014	240,986	\$ 11.76	7.88	\$ 1,518,623
Fully vested and exercisable at June 30, 2014	84,428	\$ 11.58	7.88	\$ 547,093
Expected to vest in future periods	156,558			
Fully vested and expected to vest June 30, 2014	240,986	\$ 11.76	7.88	\$ 1,518,623

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(1)

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Based on closing price of \$18.06 per share on June 30, 2014.

Intrinsic value for stock options is defined as the difference between the current market value and the exercise price.

The fair value for each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model that uses the following assumptions. The Company uses the U.S. Treasury yield curve in effect at the time of the grant to determine the risk-free interest rate. The expected dividend yield is estimated using the projected annual dividend level and recent stock price of the Company's common stock at the date of grant. Expected stock volatility is based on historical volatilities of the SNL Financial Index of Thrifts. The expected life of the options is calculated based on the "simplified" method as provided for under Staff Accounting Bulletin No.110.

Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 14 STOCK BASED COMPENSATION (Continued)**

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

	2014	2012
Risk-free interest rate	2.32%	1.54%
Expected dividend yield	2.33	3.45
Expected stock volatility	15.50	15.30
Expected life (years)	8.00	8.00
Fair value	\$ 2.46	\$ 1.00

Stock options are assumed to be earned ratably over their respective vesting periods and charged to compensation expense based upon their grant date fair value and the number of options assumed to be earned. There were 42,904 and 42,213 options that were earned during the years ended June 30, 2014 and 2013, respectively. Stock-based compensation expense for stock options for the years ended June 30, 2014 and 2013 was \$44 and \$42, respectively. Total unrecognized compensation cost related to nonvested stock options was \$156 at June 30, 2014 and is expected to be recognized over a weighted-average period of 3.6 years.

The following table summarizes non-vested restricted stock activity for the year ended June 30, 2014:

	June 30, 2014
Balance beginning of year	71,095
Granted	12,600
Forfeited	
Vested	(15,996)
Balance end of period	67,699

Weighted average grant date fair value	\$ 12.29
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The fair value of the restricted stock awards is amortized to compensation expense over their respective vesting periods and is based on the market price of the Company's common stock at the date of grant multiplied by the number of shares granted that are expected to vest. The weighted-average grant date fair value of restricted stock granted during the year ended June 30, 2014 was \$17.16 per share or \$216. Total shares of restricted stock granted under the Plan is 99,694 of which 67,699 remain unvested at June 30, 2014. The weighted-average grant date fair value of all shares granted is \$12.29 per share. Stock-based compensation expense for restricted stock included in non-interest expense for the years ended June 30, 2014 and 2013 was \$204 and \$185, respectively. Unrecognized compensation expense for nonvested restricted stock awards was \$789 and is expected to be recognized over 3.8 years.



Table of Contents**OCONEE FEDERAL FINANCIAL CORP.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****As of and for the Years Ended June 30, 2014 and 2013****(Amounts in thousands, except share and per share data)****NOTE 15 SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental cash flow information for the years ended June 30, 2014 and 2013 is as follows:

	June 30, 2014	June 30, 2013
Cash paid during the period for:		
Interest paid	\$ 1,482	\$ 2,193
Income taxes paid	\$ 2,305	\$ 1,985
Supplemental noncash disclosures:		
Transfers from loans to real estate owned	\$ 68	\$ 1,387
Unrealized gains (losses) on securities available-for-sale, net	\$ 384	\$ (1,158)
Transfer from securities held-to-maturity to available-for-sale	\$ 7,805	\$
Unrealized gains on securities held-to-maturity, transferred to available for sale	\$ 45	\$
Unsettled investment trades	\$ 1,145	\$

**NOTE 16 PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION****CONDENSED BALANCE SHEETS  
JUNE 30, 2014 AND 2013**

	June 30, 2014	June 30, 2013
<b>ASSETS</b>		
Cash and cash equivalents	\$ 4,109	\$ 1,556
Securities available-for-sale	299	297
ESOP loan receivable	1,924	2,175
Other	433	53
Investment in banking subsidiary	70,517	72,107
<b>Total assets</b>	<b>\$ 77,282</b>	<b>\$ 76,188</b>

**LIABILITIES AND SHAREHOLDERS' EQUITY**

Accounts payable and other liabilities	301	26
Shareholders' equity	76,981	76,162
<b>Total liabilities and shareholders' equity</b>	<b>\$ 77,282</b>	<b>\$ 76,188</b>





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As of and for the Years Ended June 30, 2014 and 2013

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

**NOTE 16 PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION (Continued)****CONDENSED STATEMENTS OF INCOME  
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

	June 30, 2014	June 30, 2013
Interest income	\$ 85	\$ 105
Other income		38
Dividend from banking subsidiary	6,677	7,310
Other expenses	547	348
Income before equity in undistributed income of subsidiary	6,215	7,105
Income in undistributed income of subsidiary	(2,731)	(3,134)
Income before income taxes	3,484	3,971
Income tax expense	(155)	(69)
Net income	\$ 3,639	\$ 4,040

**CONDENSED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

	June 30, 2014	June 30, 2013
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 3,639	\$ 4,040
Adjustments to reconcile net income to net cash provided by		
Change in other assets	(382)	(13)
Change in accounts payable and other liabilities	275	(22)
Gain on sale of available-for-sale securities		(38)
Equity in undistributed income of subsidiary	2,731	3,134
Net cash provided by operations	6,263	7,101

**Cash Flows From Investing Activities**

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Purchases of securities available-for-sale		(462)
Proceeds from sales of securities available-for-sale		500
Payments received on ESOP loans	152	77

Net cash provided by investing activities	152	115
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**Cash Flows from Financing Activities**

Purchases of treasury shares	(1,626)	(7,777)
Dividends paid	(2,236)	(2,418)

Net cash used in financing activities	(3,862)	(10,195)
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Change in cash and cash equivalents	2,553	(2,979)
Cash and cash equivalents, beginning of year	1,556	4,535

Cash and cash equivalents, end of year	\$ 4,109	\$ 1,556
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**OCONEE FEDERAL FINANCIAL CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**As of and for the Years Ended June 30, 2014 and 2013**

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

**NOTE 17 MERGER**

On February 26, 2014, the Company and its wholly-owned subsidiary, Oconee Federal Savings and Loan Association ("Oconee Federal"), and Oconee Federal, MHC ("Oconee MHC"), the Company's parent and Stephens Federal Bank, a federally chartered mutual savings bank ("Stephens Federal") entered into a definitive merger agreement (as amended, the "Merger Agreement"). On May 6, 2014, the Merger Agreement was amended to change the contemplated structure of the Merger Agreement. The Merger Agreement's terms stipulate that Stephens Federal will undergo a full Supervisory Conversion from a mutual savings bank to a federally chartered stock savings bank. Concurrent with the Supervisory Conversion, Stephens Federal will merge with and into Oconee Federal with Oconee Federal as the surviving institution (the "Merger"), and the separate existence of Stephens Federal will cease. Additionally, at the time of the Merger, the Company will issue to Oconee MHC a number of shares of OFED Common Stock equal to the quotient of (i) the Valuation of Stephens Federal as prepared by an independent third party, *divided by* (ii) the average of the closing sales price of a share of OFED Common Stock, as reported on the Nasdaq stock market, for the twenty (20) consecutive trading days ending on the second trading day preceding the Effective Time of the Merger, and each share of the common stock of Stephens Federal issued pursuant to the Supervisory Conversion and outstanding immediately prior to the Effective Time shall cease to be outstanding and shall immediately be canceled and retired and cease to exist.

The Office of the Comptroller of Currency approved Stephens Federal's application for Supervisory Conversion on August 29, 2014 and our application for Merger on September 3, 2014. The Federal Reserve Board approved our application to acquire Stephens Federal on September 9, 2014. The Supervisory Conversion approval requires the Supervisory Conversion to be completed by September 29, 2014, and the Merger approval requires the Merger to be completed by December 9, 2014. Stephens Federal has requested an extension of the Supervisory Conversion deadline. We expect to close the Merger in the second quarter of fiscal year 2015. Based on preliminary estimates, the Merger is expected to increase total assets by approximately \$150 million, although final amounts are subject to change. The Merger will be accounted for as an acquisition of a business using acquisition accounting, which requires that all identifiable assets and liabilities to be recorded at fair value, including any intangible assets and liabilities.

**NOTE 18 SUBSEQUENT EVENTS**

On July 24, 2014, the Board of Directors of the Company declared a quarterly cash dividend of \$0.10 per share of the Company's common stock payable to stockholders of record as of August 7, 2014, which was paid on August 21, 2014.

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**ITEM 9. *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

**ITEM 9A. *Controls and Procedures***

(a)

***Evaluation of Disclosure Controls and Procedures.***

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the fiscal year. Based upon that evaluation, the principal executive officer and principal financial officer concluded that, as of June 30, 2014, our disclosure controls and procedures were effective.

(b)

***Management's Annual Report on Internal Control over Financial Reporting***

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's system of internal control is designed under the supervision of management, including our Chief Executive Officer and Chief Financial Officer over financial reporting, to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of the Company's consolidated financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles ("GAAP").

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with GAAP, and that receipts and expenditures are made only in accordance with the authorization of management and the Board of Directors; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on our consolidated financial statements.

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

As of June 30, 2014, management assessed the effectiveness of the Company's internal control over financial reporting based upon the framework established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based upon its assessment, management believes that the Company's internal control over financial reporting as of June 30, 2014 is effective using these criteria. This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company (as a smaller reporting company) to provide only management's report in this annual report.

(c)

***Changes in Internal Control Over Financial Reporting***

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

Table of Contents**ITEM 9B. Other Information**

Not applicable.

**PART III****ITEM 10. Directors, Executive Officers and Corporate Governance**

The information contained under the sections captioned "Proposal I Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement for the 2014 Annual Meeting of Stockholders (the "Proxy Statement") is incorporated herein by reference.

**ITEM 11. Executive Compensation**

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

**ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

- (a) **Securities Authorized for Issuance Under Stock-Based Compensation Plans.** The following table sets forth information as of June 30, 2014 about Company common stock that may be issued under the Company's equity compensation plans.

**EQUITY COMPENSATION PLAN INFORMATION**

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under stock-based compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by security holders(1)	240,986	\$ 11.76	70,066
Total	240,986	\$ 11.76	70,066

- (1) These awards were granted pursuant to the Oconee Federal Financial Corp. 2013 Equity Incentive Plan.

- (b) **Security Ownership of Certain Beneficial Owners.** The information required by this item is incorporated herein by reference to the section captioned "Voting Securities and Principal Holders" in the Proxy Statement.

- (c)

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

(d)

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

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

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

**ITEM 14. *Principal Accountant Fees and Services***

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

**PART IV**

**ITEM 15. *Exhibits and Financial Statement Schedules***

- 3.1 Charter of Oconee Federal Financial Corp.(1)
- 3.2 Bylaws of Oconee Federal Financial Corp.(2)
- 4 Form of Common Stock Certificate(1)
- 10.1 Form of Employee Stock Ownership Plan(1)
- 10.2 Non-Qualified Salary Continuation Agreement by and between Oconee Federal Savings and Loan Association and T. Rhett Evatt(1)
- 10.3 Deferred Compensation Agreement by and between Oconee Federal Savings and Loan Association and W. Maurice Poore(1)
- 10.4 Deferred Compensation Agreement by and between Oconee Federal Savings and Loan Association and Cecil T. Sandifer, Jr.(1)
- 10.5 Form of Employment Agreement by and between Oconee Federal Savings and Loan Association and T. Rhett Evatt(1)
- 10.6 Form of Employment Agreement by and between Oconee Federal Savings and Loan Association and Curtis T. Evatt(1)
- 10.7 Oconee Federal Savings and Loan Association Endorsement Split Dollar Life Insurance Plan for Curtis T. Evatt and Nancy M. Carter(3)
- 10.8 Oconee Federal Financial Corp. 2013 Equity Incentive Plan.(4)
- 21 Subsidiaries of Registrant(1)
- 23.1 Consent of Independent Registered Public Accounting Firm
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets as of June 30, 2014 and 2013, (ii) the Consolidated Statements of Income and Comprehensive Income for the years ended June 30, 2014 and 2013, (iii) the Consolidated Statements of Shareholders' Equity for the years ended June 30, 2014 and 2013, (iv) the Consolidated Statements of Cash Flows for the years ended June 30, 2014 and 2013, and (v) the Notes to the Consolidated Financial Statements.(2)

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- (1) Incorporated by reference to the Registration Statement on Form S-1 (File no. 333-169419), as initially filed September 16, 2010, and as subsequently amended.
- (2) Incorporated by reference to the current report on Form 8-K (File No. 001-35033), filed on April 26, 2013.
- (3) Incorporated by reference to the current report on Form 8-K (File No. 001-35033), filed on June 28, 2013.
- (4) Incorporated by reference to the proxy statement for the special meeting of stockholders (File No. 001-35033), filed February 23, 2013.



