Oconee Federal Financial Corp.
Form 10-Q
February 10, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period ended December 31, 2016

Or

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

For transition period from to

Commission File Number 001-35033

Oconee Federal Financial Corp.

(Exact Name of Registrant as Specified in Charter)

Federal	**32-0330122**
(State of Other Jurisdiction	**(I.R.S Employer**
of Incorporation)	**Identification Number)**
201 East North Second Street, Seneca, South Carolina **(Address of Principal Executive Officers)**	**29678** **(Zip Code)**

(864) 882-2765

Registrant's telephone number, including area code

Not Applicable

(Former name or former address, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during

the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨ Accelerated filer ¨

Non-accelerated filer ¨ Smaller reporting company x

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date.

There were 5,790,965 shares of Common Stock, par value $0.01 per share, outstanding as of February 9, 2017.

OCONEE FEDERAL FINANCIAL CORP.

Form 10-Q Quarterly Report

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OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED BALANCE SHEETS

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

(Unaudited)

PART I

ITEM 1. FINANCIAL STATEMENTS

	December 31, 2016 **(Unaudited)**	June 30, 2016 **(Audited)**
ASSETS		
Cash and due from banks	$ 5,504	$ 4,874
Interest-earning deposits	20,174	22,802
Total cash and cash equivalents	25,678	27,676
Securities available-for-sale	120,654	132,084
Loans	301,537	292,063
Allowance for loan losses	(996)	(922)
Net loans	300,541	291,141
Loans held for sale, at fair value	-	129
Premises and equipment, net	6,665	6,811
Real estate owned, net	752	1,354
Accrued interest receivable		
Loans	937	1,016
Investments	557	492
Restricted equity securities, at cost	1,021	1,021
Bank owned life insurance	17,811	17,558
Goodwill	2,593	2,593
Core deposit intangible	664	744
Loan servicing rights	1,219	1,046
Deferred tax assets	2,585	1,128
Other assets	401	847
Total assets	$ 482,078	$ 485,640
LIABILITIES		
Deposits		
Noninterest bearing	$ 26,058	$ 23,356

Interest bearing	370,355	376,278
Total deposits	396,413	399,634
Accrued interest payable and other liabilities	1,758	605
Total liabilities	398,171	400,239
SHAREHOLDERS' EQUITY		
Common stock, $0.01 par value, 100,000,000 shares authorized; 6,463,039 shares issued and outstanding, respectively	65	65
Treasury stock, at par, 672,074 and 634,131 shares, respectively	(7)	(6)
Additional paid-in capital	12,423	12,882
Retained earnings	73,393	71,909
Accumulated other comprehensive (loss) income	(860)	1,808
Unearned ESOP shares	(1,107)	(1,257)
Total shareholders' equity	83,907	85,401
Total liabilities and shareholders' equity	$ 482,078	$ 485,640

See accompanying notes to the consolidated financial statements

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OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

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

(Unaudited)

	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Interest and dividend income:				
Loans, including fees	$ 3,639	$ 3,850	$ 7,376	$ 7,734
Securities, taxable	388	430	831	820
Securities, tax-exempt	180	119	358	208
Interest-earning deposits and other	36	26	77	42
Total interest income	4,243	4,425	8,642	8,804
Interest expense:				
Deposits	323	295	643	584
Total interest expense	323	295	643	584
Net interest income	3,920	4,130	7,999	8,220
Provision for loan losses	24	277	89	422
Net interest income after provision for loan losses	3,896	3,853	7,910	7,798
Noninterest income:				
Service charges on deposit accounts	107	121	211	240
Income on bank owned life insurance	127	132	253	240
Mortgage banking income	82	95	175	191
Gain on sales of securities	57	-	125	9
Gain on disposition of purchase credit impaired loans	120	90	196	809
Other	2	14	3	19
Total noninterest income	495	452	963	1,508
Noninterest expense:				
Salaries and employee benefits	1,629	1,857	3,141	3,346
Occupancy and equipment	370	354	738	714
Data processing	140	110	270	258
Professional and supervisory fees	249	167	456	417
Office expense	44	58	96	99
Advertising	46	63	77	100
FDIC deposit insurance	35	53	91	108
Foreclosed assets, net	2	47	37	222
Change in loan servicing asset	(196)	22	(173)	86
Other	136	173	316	328
Total noninterest expense	2,455	2,904	5,049	5,678
Income before income taxes	1,936	1,401	3,824	3,628

Income tax expense	618	452	1,233	1,237
Net income	$ 1,318	$ 949	$ 2,591	$ 2,391
Other comprehensive income				
Unrealized (losses) gains on securities available-for-sale	$ (3,524)	$ (579)	$ (4,043)	$ 204
Tax effect	1,268	209	1,455	(74)
Reclassification adjustment for gains realized in net income	(57)	-	(125)	(9)
Tax effect	21	-	45	3
Total other comprehensive (loss) income	(2,292)	(370)	(2,668)	124
Comprehensive (loss) income	$ (974)	$ 579	$ (77)	$ 2,515
Basic net income per share: (Note 3)	$ 0.23	$ 0.17	$ 0.46	$ 0.42
Diluted net income per share: (Note 3)	$ 0.23	$ 0.16	$ 0.45	$ 0.41
Dividends declared per share:	$ 0.10	$ 0.10	$ 0.20	$ 0.20

See accompanying notes to the consolidated financial statements

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OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

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

	Common Stock	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Unearned ESOP Shares	Total
Balance at July 1, 2015	$ 65	$ (6)	$ 13,354	$ 68,950	$ (26)	$ (1,547)	$ 80,790
Net income	-	-	-	2,391	-	-	2,391
Other comprehensive income	-	-	-	-	124	-	124
Purchase of 1,800 shares of treasury stock [(1)]	-	-	(32)	-	-	-	(32)
Stock-based compensation expense	-	-	151	-	-	-	151
Dividends [(2)]	-	-	35	(1,128)	-	-	(1,093)
ESOP shares earned	-	-	156	-	-	184	340
Balance at December 31, 2015	$ 65	$ (6)	$ 13,664	$ 70,213	$ 98	$ (1,363)	$ 82,671
Balance at July 1, 2016	$ 65	$ (6)	$ 12,882	$ 71,909	$ 1,808	$ (1,257)	$ 85,401
Net income	-	-	-	2,591	-	-	2,591
Other comprehensive loss	-	-	-	-	(2,668)	-	(2,668)
Purchase of 37,943 shares of treasury stock [(3)]	-	(1)	(777)	-	-	-	(778)
Stock-based compensation expense	-	-	151	-	-	-	151
Dividends [(4)]	-	-	44	(1,107)	-	-	(1,063)
ESOP shares earned	-	-	123	-	-	150	273
Balance at December 31, 2016	$ 65	$ (7)	$ 12,423	$ 73,393	$ (860)	$ (1,107)	$ 83,907

(1) The weighted average cost of treasury shares purchased during the six months ended was $18.34 per share. Treasury stock repurchases were accounted for using the par value method.

(2) Approximately $99 of cash dividends paid on shares in the ESOP was used as an additional principal reduction on the ESOP debt, resulting in the release of approximately 7,891 additional shares. The portion of the dividend paid on allocated shares of approximately $35 was treated as a dividend. The remaining portion of the dividend payment and resulting release of approximately 7,891 shares was accounted for as additional compensation expense of approximately $64 for the six months ended December 31, 2015.

(3) The weighted average cost of treasury shares purchased during the six months ended was $20.48 per share. Treasury stock repurchases were accounted for using the par value method.

(4) Approximately $99 of cash dividends paid on shares in the ESOP was used as an additional principal reduction on the ESOP debt, resulting in the release of approximately 8,938 additional shares. The portion of the dividend paid on allocated shares of approximately $44 was treated as a dividend. The remaining portion of the dividend payment and resulting release of approximately 8,938 shares was accounted for as additional compensation expense of approximately $55 for the six months ended December 31, 2016.

See accompanying notes to the consolidated financial statements

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OCONEE FEDERAL FINANCIAL CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

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

	Six Months Ended December 31, 2016	December 31, 2015
Cash Flows From Operating Activities		
Net income	$2,591	$ 2,391
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	89	422
Provision for real estate owned	103	110
Depreciation and amortization, net	745	557
Net amortization (accretion) of purchase accounting adjustments	119	(78)
Deferred income tax expense	44	848
Net (gain) loss on sale of real estate owned	(86)	59
Change in loan servicing asset	(173)	86
Gain on sales of securities	(125)	(9)
Mortgage loans originated for sale	(1,543)	(2,532)
Mortgage loans sold	1,707	2,690
Gain on sales of mortgage loans	(35)	(40)
Increase in cash surrender value of bank owned life insurance	(253)	(240)
Gain on disposition of purchased credit impaired loans	(196)	(809)
ESOP compensation expense	273	340
Stock based compensation expense	151	151
Net change in operating assets and liabilities:		
Accrued interest receivable and other assets	460	(60)
Accrued interest payable and other liabilities	1,153	787
Net cash provided by operating activities	5,024	4,673
Cash Flows From Investing Activities		
Purchases of premises and equipment	(71)	(57)
Purchases of securities available-for-sale	(19,779)	(23,465)
Proceeds from maturities, paydowns and calls of securities available-for-sale	11,069	9,142
Proceeds from sales of securities available-for-sale	15,648	1,164
Purchases of bank owned life insurance	-	(8,000)
Proceeds from sale of real estate owned	739	1,448
Dispositions of purchased credit impaired loans	566	2,648
Loan originations and repayments, net	(10,132)	8,535
Net cash used in investing activities	(1,960)	(8,585)

Cash Flows from Financing Activities		
Net change in deposits	(3,221)	3,075
Dividends paid	(1,063)	(1,093)
Purchase of treasury stock	(778)	(32)
Net cash (used in) provided by financing activities	(5,062)	1,950
Change in cash and cash equivalents	(1,998)	(1,962)
Cash and cash equivalents, beginning of period	27,676	26,192
Cash and cash equivalents, end of period	$25,678	$ 24,230

See accompanying notes to the consolidated financial statements

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

(1) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Oconee Federal Financial Corp., which include the accounts of its wholly owned subsidiary Oconee Federal Savings and Loan Association (the "Association") (referred to herein as "the Company," "we," "us," or "our") have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Intercompany accounts and transactions are eliminated during consolidation. The Company is majority owned (71.91%) by Oconee Federal, MHC. These financial statements do not include the transactions and balances of Oconee Federal, MHC.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company's financial position as of December 31, 2016 and June 30, 2016 and the results of operations and cash flows for the interim periods ended December 31, 2016 and 2015. All interim amounts have not been audited, and the results of operations for the interim periods herein are not necessarily indicative of the results of operations to be expected for the year or any other period. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended June 30, 2016.

Certain amounts have been reclassified to conform to the current period presentation. The reclassifications had no effect on net income or shareholders' equity as previously reported.

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

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

(2) NEW ACCOUNTING STANDARDS

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-15, Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 provides cash flow statement classification guidance for certain transactions including how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied retrospectively. Early adoption is permitted, including adoption in an interim period. The Company is assessing ASU 2016-15 but does not expect that it will have a significant impact on its accounting and disclosures.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326) - Measurement of Credit Losses on Financial Instruments. The provisions of ASU 2016-13 were issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. ASU 2016-13 requires that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in ASU 2016-13 eliminate the probable incurred loss recognition in current GAAP and reflect an entity’s current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

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

OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

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

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

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

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

(3) EARNINGS PER SHARE (“EPS”)

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

stock options) or which could be converted into common stock, if dilutive, using the treasury stock method. The factors used in the earnings per common share computation follow:

	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Earnings per share				
Net income	$ 1,318	$ 949	$ 2,591	$ 2,391
Less: distributed earnings allocated to participating securities	(3)	(6)	(7)	(13)
Less: (undistributed income) dividends in excess of earnings allocated to participating securities	(6)	(4)	(11)	(12)
Net earnings available to common shareholders	$ 1,309	$ 939	$ 2,573	$ 2,366
Weighted average common shares outstanding including participating securities	5,793,350	5,881,847	5,802,651	5,881,993
Less: participating securities	(40,905)	(62,502)	(40,905)	(62,502)
Less: average unearned ESOP shares	(111,218)	(141,676)	(115,104)	(144,160)
Weighted average common shares outstanding	5,641,227	5,677,669	5,646,642	5,675,331
Basic earnings per share	$ 0.23	$ 0.17	$ 0.46	$ 0.42
Weighted average common shares outstanding	5,641,227	5,677,669	5,646,642	5,675,331
Add: dilutive effects of assumed exercises of stock options	96,097	71,507	89,680	71,221
Average shares and dilutive potential common shares	5,737,324	5,749,176	5,736,322	5,746,552
Diluted earnings per share	$ 0.23	$ 0.16	$ 0.45	$ 0.41

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

During the three months ended December 31, 2016, no shares were considered anti-dilutive. During the six months ended December 31, 2016, 28,700 shares were considered anti-dilutive as the exercise price was below the average market price for the respective periods. During the three and six months ended December 31, 2015, 15,400 shares were considered anti-dilutive as the exercise price was below the average market price for the respective periods.

(4) SECURITIES AVAILABLE-FOR-SALE

Debt, mortgage-backed and equity securities have been classified in the consolidated balance sheets according to management's intent. U.S. Government agency mortgage-backed securities consist of securities issued by U.S. Government agencies and U.S. Government sponsored enterprises. Investment securities at December 31, 2016 and June 30, 2016 are as follows:

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
FHLMC common stock	$ 20	$ 284	$ -	$ 304
Certificates of deposit	7,723	30	(16)	7,737
Corporate debt securities	-	-	-	-
Municipal securities	36,016	18	(830)	35,204
SBA loan pools	627	4	-	631
U.S. Government agency mortgage-backed securities	65,559	192	(822)	64,929
U.S. Government agency bonds	12,052	18	(221)	11,849
Total available-for-sale	$ 121,997	$ 546	$ (1,889)	$ 120,654

June 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale:				
FHLMC common stock	$ 20	$ 131	$ -	$ 151
Certificates of deposit	7,470	64	-	7,534

Corporate debt securities	8,932	186	(2)	9,116
Municipal securities	33,508	989	(16)	34,481
SBA loan pools	1,268	8	(3)	1,273
U.S. Government agency mortgage-backed securities	68,103	1,331	(31)	69,403
U.S. Government agency bonds	9,957	169	-	10,126
Total available-for-sale	$ 129,258	$ 2,878	$ (52)	$ 132,084

Securities pledged at December 31, 2016 and June 30, 2016 had fair values of $5,990 and $6,114, respectively. These securities were pledged to secure public deposits.

At December 31, 2016 and June 30, 2016, there were no holdings of securities of any one issuer, other than U.S. Government agencies and U.S. Government sponsored enterprises, in an amount greater than 10% of shareholders' equity.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

The following tables show the fair value and unrealized loss of securities that have been in unrealized loss positions for less than twelve months and for more than twelve months at December 31, 2016 and June 30, 2016. The tables also show the number of securities in an unrealized loss position for each category of investment security as of the respective dates.

	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Loss	**Number in Unrealized Loss** [(1)]	Fair Value	Unrealized Loss	**Number in Unrealized Loss** [(1)]	Fair Value	Unrealized Loss	**Number in Unrealized Loss** [(1)]
December 31, 2016									
Available-for-sale:									
Certificates of deposit	$1,731	$(16)	7	$-	$ -	-	$1,731	$(16)	7
Municipal securities	31,019	(808)	76	697	(22)	2	31,716	(830)	78
U.S. Government agency mortgage-backed securities	46,597	(743)	47	2,542	(79)	4	49,139	(822)	51
U.S. Government agency bonds	9,830	(221)	9	-	-	-	9,830	(221)	9
	$89,177	$(1,788)	139	$3,239	$(101)	6	$92,416	$(1,889)	145

	Less than 12 Months			12 Months or More			Total		
	Fair Value	Unrealized Loss	**Number in Unrealized Loss** [(1)]	Fair Value	Unrealized Loss	**Number in Unrealized Loss** [(1)]	Fair Value	Unrealized Loss	**Number in Unrealized Loss** [(1)]
June 30, 2016									
Available-for-sale:									
Municipal securities	$2,574	$(11)	5	$716	$(5)	2	$3,290	$(16)	7
Corporate debt securities	1,018	(2)	2	-	-	-	1,018	(2)	2
SBA loan pools	-	-	-	508	(3)	1	508	(3)	1
U.S. Government agency mortgage-backed securities	1,057	(1)	1	2,982	(30)	4	4,039	(31)	5

	$4,649	$ (14)	8	$4,206	$ (38)	7	$8,855	$ (52)	15

(1) Actual amounts.

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

None of the unrealized losses at December 31, 2016 were recognized into net income for the three or six months ended December 31, 2016 because the issuers' bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates. The fair value of these securities is expected to recover as they approach their maturity date or reset date. None of the unrealized losses at June 30, 2016 were recognized as having OTTI during the year ended June 30, 2016.

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OCONEE FEDERAL FINANCIAL CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

The following table presents the amortized cost and fair value of debt securities classified as available-for-sale at December 31, 2016 and June 30, 2016 by contractual maturity. FHLMC common stock is not presented in this table.

	December 31, 2016		June 30, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Less than one year	$3,237	$3,244	$3,740	$3,751
Due from one to five years	13,147	13,102	16,819	17,086
Due from five to ten years	30,648	29,970	30,778	31,622
Due after ten years	8,759	8,474	8,530	8,798
Mortgage-backed securities [1]	66,186	65,560	69,371	70,676
Total	$121,977	$120,350	$129,238	$131,933

(1) Actual cash flows may differ from contractual maturities as borrowers may prepay obligations without prepayment penalty.

The following table presents the gross proceeds from sales of securities available-for-sale and gains or losses recognized for the three and six months ended December 31, 2016 and 2015:

	Three Months Ended		Six Months Ended	
Available-for-sale:	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Proceeds	$ 12,495	$ -	$ 15,648	$ 1,164
Gross gains	57	-	125	9
Gross losses	-	-	-	-

The tax provision related to these net realized gains for the three and six months ended December 31, 2016 was $21 and $45, respectively, and for the three and six months ended December 31, 2015 was $0 and $3, respectively.

(5) LOANS

The components of loans at December 31, 2016 and June 30, 2016 were as follows:

	December 31, 2016	June 30, 2016
Real estate loans:		
One-to-four family	$ 254,216	$ 242,067
Multi-family	1,933	1,996
Home equity	5,722	6,433
Nonresidential	19,343	20,310
Agricultural	1,535	2,958
Construction and land	14,355	14,332
Total real estate loans	297,104	288,096
Commercial and industrial	167	176
Consumer and other loans	5,335	4,915
Total loans	302,606	293,187
Deferred net loan fees	(1,069)	(1,124)
Total loans net of deferred loan fees	$ 301,537	$ 292,063

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The following tables present the activity in the allowance for loan losses for the three and six months ended December 31, 2016 by portfolio segment:

Three Months Ended December 31, 2016	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
One-to-four family	$ 785	$ 10	$ -	$ -	$ 795
Multi-family	4	-	-	-	4
Home equity	2	-	-	-	2
Nonresidential	132	(8)	-	-	124
Agricultural	5	(3)	-	-	2
Construction and land	35	4	-	-	39
Total real estate loans	963	3	-	-	966
Commercial and industrial	6	(1)	-	-	5
Consumer and other loans	3	22	-	-	25
Total loans	$ 972	$ 24	$ -	$ -	$ 996

Six Months Ended December 31, 2016	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
One-to-four family	$ 733	$ 62	$ -	$ -	$ 795
Multi-family	4	-	-	-	4
Home equity	2	-	-	-	2
Nonresidential	130	9	(15)	-	124
Agricultural	5	(3)	-	-	2
Construction and land	39	-	-	-	39
Total real estate loans	913	68	(15)	-	966
Commercial and industrial	6	(1)	-	-	5
Consumer and other loans	3	22	-	-	25
Total loans	$ 922	$ 89	$ (15)	$ -	$ 996

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The following table presents the recorded balances of loans and amount of allowance allocated based upon impairment method by portfolio segment at December 31, 2016:

	Ending Allowance on Loans:			Loans:		
	Individually Evaluated for Impairment		Collectively Evaluated for Impairment	Individually Evaluated for Impairment		Collectively Evaluated for Impairment
At December 31, 2016	Non-PCI	**PCI** [(1)]		Non-PCI	**PCI** [(1)]	
Real estate loans:						
One-to-four family	$ 34	$ 74	$ 687	$ 993	$ 1,933	$ 250,337
Multi-family	-	-	4	-	-	1,932
Home equity	-	-	2	-	-	5,722
Nonresidential	-	68	56	453	903	17,974
Agricultural	-	-	2	448	-	1,086
Construction and land	-	9	30	-	509	13,759
Total real estate loans	34	151	781	1,894	3,345	290,810
Commercial and industrial	-	-	5	-	-	167
Consumer and other loans	-	-	25	-	-	5,321
Total loans	$ 34	$ 151	$ 811	$ 1,894	$ 3,345	$ 296,298

(1) "Purchase Credit Impaired" (or "PCI") loans include all loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

The following tables present the activity in the allowance for loan losses for the three and six months ended December 31, 2015 by portfolio segment:

Three Months Ended December 31, 2015	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance

Real estate loans:					
One-to-four family	$ 881	$ 148	$ (68)	$ -	$ 961
Multi-family	4	-	-	-	4
Home equity	20	53	(72)	-	1
Nonresidential	68	(1)	-	-	67
Agricultural	4	-	-	-	4
Construction and land	19	67	-	-	86
Total real estate loans	996	267	(140)	-	1,123
Commercial and industrial	8	-	-	-	8
Consumer and other loans	7	10	-	-	17
Total loans	$ 1,011	$ 277	$ (140)	$ -	$ 1,148

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Six Months Ended December 31, 2015	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
Real estate loans:					
One-to-four family	$ 910	$ 259	$ (208)	$ -	$ 961
Multi-family	4	-	-	-	4
Home equity	1	72	(72)	-	1
Nonresidential	55	12	-	-	67
Agricultural	4	-	-	-	4
Construction and land	25	61	-	-	86
Total real estate loans	999	404	(280)	-	1,123
Commercial and industrial	-	8	-	-	8
Consumer and other loans	9	10	(2)	-	17
Total loans	$ 1,008	$ 422	$ (282)	$ -	$ 1,148

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

	Ending Allowance on Loans:			Loans:		
	Individually Evaluated for Impairment		Collectively Evaluated for Impairment	Individually Evaluated for Impairment		Collectively Evaluated for Impairment
At June 30, 2016	Non-PCI	**PCI** [(1)]		Non-PCI	**PCI** [(1)]	
Real estate loans:						
One-to-four family	$ 55	$ 46	$ 632	$ 1,014	$ 1,904	$ 238,161
Multi-family	-	-	4	-	-	1,994
Home equity	-	-	2	-	-	6,575
Nonresidential	-	72	58	-	1,492	18,807
Agricultural	-	-	5	448	-	2,509
Construction and land	-	11	28	-	525	13,558
Total real estate loans	55	129	729	1,462	3,921	281,604
Commercial and industrial	-	-	6	-	-	176
Consumer and other loans	-	-	3	-	-	4,900
Total loans	$ 55	$ 129	$ 738	$ 1,462	$ 3,921	$ 286,680

(1) PCI loans include all loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected.

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The tables below present loans that were individually evaluated for impairment by portfolio segment at December 31, 2016 and June 30, 2016, including the average recorded investment balance and interest earned for the six months ended December 31, 2016 and year ended June 30, 2016:

	December 31, 2016				
	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no recorded allowance:					
Real estate loans:					
One-to-four family	$688	$ 489	$ -	$ 741	$ 24
Multi-family	-	-	-	-	-
Home equity	50	-	-	-	-
Nonresidential	1,479	907	-	1,009	26
Agricultural	997	448	-	448	18
Construction and land	818	478	-	332	19
Total real estate loans	4,032	2,322	-	2,530	87
Commercial and industrial	-	-	-	-	-
Consumer and other loans	-	-	-	-	-
Total	$4,032	$ 2,322	$ -	$ 2,530	$ 87
With recorded allowance:					
Real estate loans:					
One-to-four family	$3,058	$ 2,437	$ 108	$ 2,178	$ 111
Multi-family	-	-	-	-	-
Home equity	-	-	-	-	-
Nonresidential	558	449	68	416	20
Agricultural	-	-	-	-	-
Construction and land	185	31	9	189	11
Total real estate loans	3,801	2,917	185	2,783	142
Commercial and industrial	-	-	-	-	-
Consumer and other loans	-	-	-	-	-
Total	$3,801	$ 2,917	$ 185	$ 2,783	$ 142
Totals:					

Real estate loans	$7,833	$ 5,239	$ 185	$ 5,313	$ 229
Consumer and other loans	-	-	-	-	-
Total	$7,833	$ 5,239	$ 185	$ 5,313	$ 229

The unpaid principal balance and recorded investment includes PCI loans of $5,365 and $3,345, respectively, at December 31, 2016.

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

The unpaid principal balance and recorded investment in PCI loans was $6,546 and $3,921, respectively, at June 30, 2016.

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Purchased Credit Impaired Loans:

The Company has purchased loans, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The following table presents the carrying amount of those loans at December 31, 2016 and June 30, 2016:

	December 31, 2016	June 30, 2016
Real estate loans:		
One-to-four family	$ 1,859	$ 1,858
Multi-family	-	-
Home equity	-	-
Nonresidential	835	1,420
Agricultural	-	-
Construction and land	500	514
Total real estate loans	3,194	3,792
Commercial and industrial	-	-
Consumer and other loans	-	-
Total loans	$ 3,194	$ 3,792

Carrying amounts listed above are net of an allowance for loan losses of $151 and $129 at December 31, 2016 and June 30, 2016, respectively.

The following table presents the changes in the carrying value and the accretable yield on purchased credit impaired loans for the three and six months ended December 31, 2016 and 2015.

	Three Months Ended December 31, 2016	Three Months Ended December 31, 2015

	Accretable Yield	Carrying Value	Accretable Yield	Carrying Value
Balance at beginning of period	$ (1,312)	$ 3,694	$ (500)	$ 6,250
Payments and other exit events	(40)	(414)	(94)	(1,069)
Accretion	95	(95)	98	(98)
Reclassification from nonaccretable to accretable	-	-	(22)	-
Change in the allowance	-	9	-	(31)
Balance at end of period	$ (1,257)	$ 3,194	$ (518)	$ 5,052

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	Six Months Ended December 31, 2016		Six Months Ended December 31, 2015	
	Accretable Yield	Carrying Value	Accretable Yield	Carrying Value
Balance at beginning of year	$ (1,340)	$ 3,792	$ (694)	$ 7,429
Payments and other exit events	(75)	(418)	(104)	(2,043)
Accretion	158	(158)	302	(302)
Reclassification from nonaccretable to accretable	-	-	(22)	-
Change in the allowance	-	(22)	-	(32)
Balance at end of period	$ (1,257)	$ 3,194	$ (518)	$ 5,052

Income is not recognized on PCI loans if the Company cannot reasonably estimate cash flows expected to be collected. The carrying amount of such loans at December 31, 2016 and 2015 is as follows:

	December 31, 2016	December 31, 2015
Balance at beginning of year	$ 1,139	$ 2,798
Additions	275	132
Reductions from payments and liquidations	(607)	(963)
Balance at end of period	$ 807	$ 1,967

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

Total past due loans and nonaccrual loans at December 31, 2016:

Accruing

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	$ 6,782	$ 1,591	$ 1,160	$ 9,533	$ 243,730	$ 253,263	$ 2,420	$ -
Multi-family	-	-	-	-	1,932	1,932	-	-
Home equity	100	96	83	279	5,443	5,722	133	-
Nonresidential	-	50	813	863	18,467	19,330	813	-
Agricultural	448	-	-	448	1,086	1,534	529	-
Construction and land	-	14	-	14	14,254	14,268	282	-
Total real estate loans	7,330	1,751	2,056	11,137	284,912	296,049	4,177	-
Commercial and industrial	-	-	-	-	167	167	-	-
Consumer and other loans	1	-	-	1	5,320	5,321	-	-
Total	$ 7,331	$ 1,751	$ 2,056	$ 11,138	$ 290,399	$ 301,537	$ 4,177	$ -

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PCI past due and nonaccrual loans at December 31, 2016:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	$ 147	$ 398	$ 19	$ 564	$ 1,369	$ 1,933	$ 165	$ -
Nonresidential	-	50	360	410	493	903	360	-
Construction and land	-	-	-	-	509	509	282	-
Total loans	$ 147	$ 448	$ 379	$ 974	$ 2,371	$ 3,345	$ 807	$ -

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

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	$ 7,086	$ 1,001	$ 863	$ 8,950	$ 232,129	$ 241,079	$ 2,133	$ -
Multi-family	-	-	-	-	1,994	1,994	-	-
Home equity	94	22	84	200	6,375	6,575	126	-
Nonresidential	-	48	942	990	19,309	20,299	942	-
Agricultural	-	-	-	-	2,957	2,957	531	-
Construction and land	93	-	25	118	13,965	14,083	25	-
Total real estate loans	7,273	1,071	1,914	10,258	276,729	286,987	3,757	-

Commercial and industrial	-	-	-	-	176	176	-	-
Consumer and other loans	-	-	-	-	4,900	4,900	-	-
Total	$ 7,273	$ 1,071	$ 1,914	$ 10,258	$ 281,805	$ 292,063	$ 3,757	$ -

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Nonaccrual Loans	Accruing Loans Past Due 90 Days or More
Real estate loans:								
One-to-four family	$ -	$ 389	$ 21	$ 410	$ 1,494	$ 1,904	$ 172	$ -
Nonresidential	-	48	942	990	502	1,492	942	-
Construction and land	-	-	25	25	500	525	25	-
Total loans	$ -	$ 437	$ 988	$ 1,425	$ 2,496	$ 3,921	$ 1,139	$ -

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

Troubled Debt Restructurings:

At December 31, 2016 and June 30, 2016, total loans that have been modified as troubled debt restructurings were $1,585 and $1,588, respectively, which consisted of two agricultural loans, two home equity lines of credit, and one one-to-four family first liens at June 30, 2016 and an additional one-to-four family loan at December 31, 2016. All loans were acquired and initially recorded at fair value. An additional allowance of $34 and $55 at December 31, 2016 and June 30, 2016, respectively, has been specifically reserved for these loans. Additionally, there were no commitments to lend any additional amounts under either loan or any payment default on any loan after the modification. The one troubled debt restructuring during the six months ended December 31, 2016 involved renewal of a loan at a higher loan-to-value ratio than is offered on similar loans. No reductions of principal or interest rates were granted. No loans restructured during the twelve months ended December 31, 2016 defaulted.

Loan Grades:

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

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

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

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

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

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

Portfolio Segments:

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. The Company currently originates residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes.

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

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

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

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

Home Equity: The Company offers home equity loans and lines of credit secured by first or second deeds of trust on primary residences in our market area. The Company’s home equity loans and lines of credit are limited to an 80% loan-to-value ratio (including all prior liens). Standard residential mortgage underwriting requirements are used to evaluate these loans. The Company offers adjustable-rate and fixed-rate options for these loans with a maximum term of 10 years. The repayment terms on lines of credit are interest only monthly with principle due at maturity. Home equity loans have a more traditional repayment structure with principal and interest due monthly. The maximum term

on home equity loans is 10 years with an amortization schedule not exceed 20 years.

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

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

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

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

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

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

to the same guidelines used for originating permanent residential mortgage loans. Commercial construction loans are generally underwritten pursuant to the same guidelines used for originating commercial loans.

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

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

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

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

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

Based on the most recent analysis performed, the risk grade of loans by portfolio segment are presented in the following tables. Separate tables are presented to show the risk grade of loans that have been acquired.

Total loans by risk grade and portfolio segment at December 31, 2016:

	Pass	Pass- Watch	Special Mention	Substandard	Doubtful	Total
Real estate loans:						
One-to-four family	$238,160	$ 6,701	$ 2,230	$ 6,172	$ -	$253,263
Multi-family	1,932	-	-	-	-	1,932
Home equity	5,081	299	259	83	-	5,722
Nonresidential	12,956	3,636	1,382	1,356	-	19,330
Agricultural	340	387	278	529	-	1,534
Construction and land	12,626	863	234	545	-	14,268
Total real estate loans	271,095	11,886	4,383	8,685	-	296,049
Commercial and industrial	167	-	-	-	-	167
Consumer and other loans	5,317	-	1	3	-	5,321

Total	$276,579	$ 11,886	$ 4,384	$ 8,688	$ -	$301,537

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

	Pass	Pass-Watch	Special Mention	Substandard	Doubtful	Total
Real estate loans:						
One-to-four family	$226,899	$ 6,805	$ 1,890	$ 5,485	$ -	$241,079
Multi-family	1,994	-	-	-	-	1,994
Home equity	6,083	106	260	126	-	6,575
Nonresidential	13,218	4,095	1,494	1,492	-	20,299
Agricultural	1,352	398	676	531	-	2,957
Construction and land	12,397	878	239	569	-	14,083
Total real estate loans	261,943	12,282	4,559	8,203	-	286,987
Commercial and industrial	157	19	-	-	-	176
Consumer and other loans	4,892	-	3	5	-	4,900
Total	$266,992	$ 12,301	$ 4,562	$ 8,208	$ -	$292,063

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At December 31, 2016, consumer mortgage loans secured by residential real estate properties totaling $488 were in formal foreclosure proceedings and are included in one-to-four family loans.

(6) FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

Investment Securities:

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

using discounted cash flows or other market indicators (Level 3).

Impaired Loans:

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

Real Estate Owned:

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

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

Loan Servicing Rights:

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

Assets and liabilities measured at fair value on a recurring basis at December 31, 2016 and June 30, 2016 are summarized below:

	Fair Value Measurements			
	December 31, 2016		June 30, 2016	
	(Level 2)	(Level 3)	(Level 2)	(Level 3)
Financial assets:				
Securities available-for-sale:				
FHLMC common stock	$304	$ -	$151	$ -
Certificates of deposit	7,737	-	7,534	-
Corporate debt securities	-	-	9,116	-
Municipal securities	35,204	-	34,481	-
SBA loan pools	631	-	1,273	-
U.S. Government agency mortgage-backed securities	64,929	-	69,403	-
U.S. Government agency bonds	11,849	-	10,126	-

Total securities available-for-sale	120,654	-	132,084	-
Loan servicing rights	-	1,219	-	1,046
Total financial assets	$120,654	$ 1,219	$132,084	$ 1,046

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Presented in the table below are assets measured at fair value on a nonrecurring basis using level 3 inputs at December 31, 2016 and June 30, 2016:

	Fair Value Measurements	
	December 31, 2016 (Level 3)	June 30, 2016 (Level 3)
Financial assets:		
Impaired loans, with specific allocations:		
One-to-four family	$ 2,329	$ 1,817
Nonresidential	381	310
Construction and land	22	336
Total financial assets	2,732	2,463
Non-financial assets:		
Real estate owned, net:		
One-to-four family	752	899
Nonresidential	-	267
Construction and land	-	188
Total non-financial assets	752	1,354
Total assets measured at fair value on a non-recurring basis	$ 3,484	$ 3,817

The Company's impaired loans at December 31, 2016 and June 30, 2016 were measured at fair value based primarily upon the estimated value of real estate collateral less costs to sell. The carrying amounts of these loans were $2,732 and $2,463, respectively, which consisted of valuation allowances of $185 and $184, respectively. The impact to the provision for loan losses from the change in the valuation allowance for the three and six months ended December 31, 2016 was a decrease of $22 and an increase of $1, respectively, and for the three and six months ended December 31, 2015 was an increase of $262 and $292, respectively.

Real estate owned is carried at the lower of carrying value or fair value less costs to sell. The carrying value of real estate owned and their respective valuation allowances at December 31, 2016 and June 30, 2016 were $752 and $1,354 and $102 and $102, respectively. The resulting write-downs for measuring real estate owned at the lower of

carrying or fair value less costs to sell for the three and six months ended December 31, 2016, were $0 and $103, respectively. The resulting write-downs for measuring real estate owned at the lower of carrying or fair value less costs to sell for the three and six months ended December 31, 2015, were $15 and $110, respectively.

The tables below present a reconciliation of all Level 3 assets measured at fair value on a recurring basis using significant unobservable inputs for the three and six months ended December 31, 2016 and 2015:

	Fair Value Measurements (Level 3)			
	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	Loan Servicing Rights	Loan Servicing Rights	Loan Servicing Rights	Loan Servicing Rights
Balance at beginning of year:	$ 1,023	$ 1,332	$ 1,046	$ 1,396
Purchases	-	-	-	-
Change in fair value	196	(22)	173	(86)
Balance at end of period:	$ 1,219	$ 1,310	$ 1,219	$ 1,310

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The table below presents the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a non-recurring basis at December 31, 2016 and June 30, 2016.

	Level 3 Quantitative Information				
	December 31, 2016	June 30, 2016	Valuation Technique	Unobservable Inputs	Range
	Fair Value	Fair Value			
Loan servicing rights	$1,219	$ 1,046	Discounted cash flows	Discount rate, estimated timing of cash flows	9% to 10%
Impaired real estate loans net, with specific allocations:					
One-to-four family	$2,329	$ 1,817	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 30%
Nonresidential	381	310	Discounted cash flows	Discount rate, estimated timing of cash flows	2% to 28%
Construction and land	22	336	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 30%
Real estate owned net:					
One-to-four family	$752	$ 899	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20%
Nonresidential	-	267	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20%
Construction and land	-	188	Sales comparison approach	Adjustment for differences between the comparable sales	0% to 20%

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Many of the Company's assets and liabilities are short-term financial instruments whose carrying amounts reported in the consolidated balance sheet approximate fair value. These items include cash and cash equivalents, accrued interest receivable and payable balances, variable rate loan and deposits that re-price frequently and fully. The estimated fair values of the Company's remaining on-balance sheet financial instruments at December 31, 2016 and June 30, 2016 are summarized below:

	December 31, 2016				
	Carrying	Fair Value			
	Amount	(Level 1)	(Level 2)	(Level 3)	Total
Financial assets					
Securities available-for-sale	$120,654	$-	$120,654	$-	$120,654
Loans, net	300,541	-	-	305,807	305,807
Loan servicing rights	1,219	-	-	1,219	1,219
Restricted equity securities	1,021	N/A	N/A	N/A	N/A
Financial liabilities					
Deposits	$396,413	$178,789	$210,488	$-	$389,277

	June 30, 2016				
	Carrying	Fair Value			
	Amount	(Level 1)	(Level 2)	(Level 3)	Total
Financial assets					
Securities available-for-sale	$132,084	$-	$132,084	$-	$132,084
Loans, net	291,141	-	-	296,203	296,203
Loans held for sale (1)	129	-	-	129	129
Loan servicing rights	1,046	-	-	1,046	1,046
Restricted equity securities	1,021	N/A	N/A	N/A	N/A
Financial liabilities					
Deposits	$399,634	$175,652	$224,037	$-	$399,689

(1) Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors and result in a Level 3 classification.

(7) EMPLOYEE STOCK OWNERSHIP PLAN

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. The Company makes contributions to the ESOP each December. In December 2016, $50 of discretionary contributions were made to the ESOP for debt retirement, which resulted in the release of additional shares and recognition of additional compensation expense of $88 for both the three and six months ended December 31, 2016. In December 2015, $100 of discretionary contributions were made to the ESOP for debt retirement, which resulted in the release of additional shares and recognition of additional compensation expense of $160 for both the three and six months ended December 31, 2015. Total ESOP compensation expense for the three and six months ended December 31, 2016 was $181 and $273, respectively, and for the three and six months ended December 31, 2015 was $250 and $340, respectively.

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Shares held by the ESOP at December 31, 2016 and June 30, 2016 were as follows:

	December 31, 2016	June 30, 2016
Committed to be released to participants	25,793	10,602
Allocated to participants	112,043	112,043
Unearned	104,010	126,197
Total ESOP shares	241,846	248,842
Fair value of unearned shares	$ 2,444	$2,470

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

The following table summarizes stock option activity for the six months ended December 31, 2016:

	Options	Weighted-Average Exercise Price/Share	Weighted-Average Remaining Contractual Life (in years)	**Aggregate Intrinsic Value (1)**
Outstanding - July 1, 2016	261,986	$ 12.46		
Granted	-	-		
Exercised	-	-		
Forfeited	-	-		
Outstanding - December 31, 2016	261,986	$ 12.46	2.40	$2,892,325
Fully vested and exercisable at December 31, 2016	169,954	$ 11.65	2.40	$2,013,955
Expected to vest in future periods	92,032			
Fully vested and expected to vest - December 31, 2016	261,986	$ 12.46	2.40	$2,892,325

(1) The intrinsic value for stock options is defined as the difference between the current market value and the exercise price. The current market price was based on the closing price of common stock of $23.50 per share on December 31, 2016.

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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 generally accepted accounting principles.

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

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

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 23,750 and 21,835 options that were earned during the six months ended December 31, 2016 and 2015, respectively. Stock-based compensation expense for stock options for the three and six months ended December 31, 2016 was $14 and $28, respectively, and for the three and six months ended December 31, 2015 was $12 and $24, respectively. Total unrecognized compensation cost related to stock options was $97 at December 31, 2016 and is expected to be recognized over a weighted-average period of 2.4 years.

The following table summarizes non-vested restricted stock activity for the six months ended December 31, 2016:

	December 31, 2016
Balance - beginning of year	40,905
Granted	-
Forfeited	-
Vested	-
Balance - end of period	40,905
Weighted average grant date fair value	$ 13.09

The fair value of the restricted stock awards is amortized to compensation expense over their respective vesting periods and is based on the market price of the Company’s common stock at the date of grant multiplied by the number of shares granted that are expected to vest. The weighted-average grant date fair value of restricted stock granted on January 23, 2015 was $20.01 per share or $252. The weighted-average grant date fair value of restricted stock granted on February 5, 2016 was $19.40 per share or $136. Stock-based compensation expense for restricted stock included in noninterest expense for the three and six months ended December 31, 2016 was $62 and $123, respectively, and for the three and six months ended December 31, 2015 was $64 and $127, respectively. Unrecognized compensation expense for non-vested restricted stock awards was $424 at December 31, 2016 and is expected to be recognized over a weighted-average period of 2.9 years.

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(9) LOAN SERVICING RIGHTS

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

The principal balances of those loans at December 31, 2016 and June 30, 2016 are as follows:

	December 31, 2016	June 30, 2016
Mortgage loan portfolio serviced for:		
FHLMC	$ 117,682	$ 125,812

Custodial escrow balances maintained in connection with serviced loans were $811 and $1,007 at December 31, 2016 and June 30, 2016.

Activity for loan servicing rights for the three and six months ended December 31, 2016 and 2015 is as follows:

	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Loan servicing rights:				
Beginning of period:	$ 1,023	$ 1,332	$ 1,046	$ 1,396
Additions	-	-	-	-
Change in fair value	196	(22)	173	(86)
End of period:	$ 1,219	$ 1,310	$ 1,219	$ 1,310

Fair value at December 31, 2016 was determined using a discount rate of 9.63%, prepayment speed assumptions ranging from 5.1% to 12.7% Conditional Prepayment Rate (“CPR”) depending on the loans coupon, term and seasoning, and a weighted average default rate of 0.61%. Fair value at December 31, 2015 was determined using a discount rate of 9.75%, prepayment speed assumptions ranging from 5.2% to 17.5% CPR depending on the loans’ coupon, term and seasoning, and a weighted average default rate of 0.61%.

(10) SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information for the six months ended December 31, 2016 and 2015 is as follows:

	December 31, 2016	December 31, 2015
Cash paid during the period for:		
Interest paid	$ 641	$ 591
Income taxes paid	$ 510	$ 117
Supplemental noncash disclosures:		
Transfers from loans to real estate owned	$ 154	$ 1,443

(11) SUBSEQUENT EVENTS

On January 26, 2017, the Board of Directors of Oconee Federal Financial Corp. (the “Company”) declared a quarterly cash dividend of $0.10 per share of the Company’s common stock. The dividend is payable to stockholders of record as of February 9, 2017, and will be paid on or about February 23, 2017.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly 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:

- 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 Quarterly 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;

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

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

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

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

- our ability to successfully implement our business strategies, 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;
- changes in laws or government regulations or policies affecting financial institutions, which could result in, among other things, increased deposit insurance premiums and assessments, capital requirements (particularly the new capital regulations), regulatory fees and compliance costs and the resources we have available to address such changes;
- technological changes that may be more difficult or expensive than expected;
- our reliance on a small executive staff;
- changes in our compensation and benefit plans, and our ability to retain key members of our senior management team and to address staffing needs to implement our strategic plan;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;
- our ability to control costs and expenses, particularly those related to operating as a publicly traded company;
- other changes in our financial condition or results of operations that reduce capital available to pay dividends;
- other changes in the financial condition or future prospects of issuers of securities that we own, including our stock in the FHLB of Atlanta; and
- other economic, competitive, governmental, regulatory and operational factors affecting our operations, pricing, products and services.

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

Critical Accounting Policies

There are no material changes to the critical accounting policies disclosed in the Annual Report on Form 10-K for Oconee Federal Financial Corp. for the year ended June 30, 2016, as filed with the Securities and Exchange Commission.

Comparison of Financial Condition at December 31, 2016 and June 30, 2016

Our total assets decreased by $3.6 million, or 0.7%, to $482.1 million at December 31, 2016 from $485.6 million at June 30, 2016. Total cash and cash equivalents decreased $2.0 million, or 7.2%, to $25.7 million at December 31, 2016 from $27.7 million at June 30, 2016. Our available-for-sale securities portfolio also decreased from $132.1 million at June 30, 2016 to $120.7 million at December 31, 2016. Proceeds from sales and calls of securities and excess cash was used to fund loan growth. Gross loans increased $9.5 million, or 3.2%, to $301.5 million at December 31, 2016 from $292.1 million at June 30, 2016. This increase is a result of increased loan demand experienced during the six months ended December 31, 2016.

Deposits decreased $3.2 million, or 0.8%, to $396.4 million at December 31, 2016 from $399.6 million at June 30, 2016. The decrease in our deposits reflected a decrease of $8.9 million in certificates of deposit and $387 thousand in savings deposits, offset by an increase in money market deposits of $3.2 million and NOW and demand deposits of $2.9 million. The increase in money market deposits reflects an increase in rate on certain money market accounts during the six months ended December 31, 2016 and increased efforts to offer and market our deposit products. We believe the decline in our certificates of deposit reflects depositors moving their deposits into higher yielding investments in the market.

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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 six months ended December 31, 2016.

We had no advances from the Federal Home Loan Bank of Atlanta as of December 31, 2016 or June 30, 2016. We have credit available under a loan agreement with the Federal Home Loan Bank of Atlanta in the amount of 25% of our total assets as of December 31, 2016, or approximately $120.6 million.

Total shareholders' equity decreased $1.5 million, or 1.8%, to $83.9 million at December 31, 2016 compared to $85.4 million at June 30, 2016. Our net income of $2.6 million was fully offset by our other comprehensive loss of $2.7 for the six months ended December 31, 2016. The increase in other comprehensive loss was a result of the rising interest rate environment relative to the interest rate environment in which the investment securities were purchased. Management did not believe the unrealized losses represented an other-than-temporary impairment. Dividends of $1.1 million and share repurchases of $778 thousand also contributed to the decrease in shareholders' equity during the period. The Company and the Bank exceeded all minimum regulatory capital requirements for the period.

Nonperforming Assets

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

	December 31, 2016	June 30, 2016
	(Dollars in thousands)	
Nonaccrual loans:		
Real estate loans:		
One-to-four family	$ 2,420	$ 2,133
Multi-family	-	-
Home equity	133	126
Nonresidential	813	942
Agricultural	529	531
Construction and land	282	25
Total real estate loans	4,177	3,757
Commercial and industrial	-	-
Consumer and other loans	-	-
Total nonaccrual loans [1]	$ 4,177	$ 3,757
Accruing loans past due 90 days or more:		
Real estate loans:		

Total accruing loans past due 90 days or more	$ -	$ -
Total of nonaccrual and 90 days or more past due loans[2]	$ 4,177	$ 3,757
Real estate owned, net:		
One-to-four family	$ 752	$ 899
Nonresidential	-	267
Construction and land	-	188
Other nonperforming assets	-	-
Total nonperforming assets	$ 4,929	$ 5,111
Accruing troubled debt restructurings	-	-
Troubled debt restructurings and total nonperforming assets	$ 4,929	$ 5,111
Total nonperforming loans to total loans	1.39 %	1.29 %
Total nonperforming assets to total assets	1.02 %	1.05 %
Total nonperforming assets to loans and real estate owned	1.63 %	1.74 %

(1) Nonaccrual troubled debt restructurings included in the totals above were $1,585 and $1,588, at December 31 and June 30, 2016, respectively.

(2) There were no loans past due 90 days or more and still accruing at December 31, 2016 and June 30, 2016.

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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 $127 thousand and $97 thousand for the six months ended December 31, 2016 and 2015, respectively. Interest of $45 thousand and $31 thousand, respectively, was recognized on these loans and is included in net income for the six months ended December 31, 2016 and 2015, respectively.

Interest income that would have been recorded had our troubled debt restructured loans been current in accordance with their original terms was $66 thousand and $37 thousand, respectively, for the six months ended December 31, 2016 and 2015.

Nonperforming assets decreased $182 thousand from June 30, 2016 to December 31, 2016. Nonaccrual loans increased $420 thousand while real estate owned decreased $602 thousand. There were no accruing loans past due 90 days or more at either date. The increase in nonaccrual loans primarily related to seasonal fluctuations and an increase in our TDRs as we continue to work with borrowers to avoid foreclosure. Nonperforming assets to total assets and nonperforming assets to loans and real estate owned were 1.02% and 1.63%, respectively, at December 31, 2016 compared to 1.05% and 1.74%, respectively at June 30, 2016.

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Analysis of Net Interest Margin

The following table sets forth average balance sheets, average annualized yields and rates, and certain other information for the periods indicated. No tax-equivalent yield adjustments were made, as the effect thereof was not material. All average balances are daily average balances. Nonaccrual loans were included in the computation of average balances, but have been reflected in the tables as loans carrying a zero yield. The yields set forth below include the effect of net deferred costs, discounts and premiums that are amortized or accreted to income.

	For the Three Months Ended					
	December 31, 2016			December 31, 2015		
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
	(Dollars in Thousands)					
Assets:						
Interest-earning assets:						
Loans	$298,374	$ 3,639	4.88 %	$300,351	$ 3,850	5.13 %
Investment securities	92,930	388	1.67	98,791	430	1.74
Investment securities, tax-free	33,145	180	2.17	21,600	119	2.20
Interest-earning deposits	16,917	36	0.85	19,555	26	0.53
Total interest-earning assets	441,366	4,243	3.85	440,297	4,425	4.02
Noninterest-earning assets	39,150			41,661		
Total assets	$480,516			$481,958		
Liabilities and equity:						
Interest-bearing liabilities:						
NOW and demand deposits	$48,313	$ 12	0.10 %	$50,029	$ 10	0.08 %
Money market deposits	79,244	72	0.36	62,139	49	0.32
Regular savings and other deposits	28,410	10	0.14	24,298	6	0.10
Certificates of deposit	213,853	229	0.43	239,525	230	0.39
Total interest-bearing deposits	369,820	323	0.35	375,991	295	0.31
Total interest-bearing liabilities	369,820	323	0.35	375,991	295	0.31
Noninterest bearing deposits	24,648			20,641		
Other noninterest-bearing liabilities	1,421			2,262		
Total liabilities	395,889			398,894		
Equity	84,627			83,064		
Total liabilities and equity	$480,516			$481,958		
Net interest income		$ 3,920			$ 4,130	
Interest rate spread			3.50 %			3.71 %
Net interest margin			3.55 %			3.75 %
Average interest-earning assets to average interest-bearing liabilities	1.19 x			1.17 x		

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	For the Six Months Ended					
	December 31, 2016			December 31, 2015		
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
	(Dollars in Thousands)					
Assets:						
Interest-earning assets:						
Loans	$295,733	$ 7,376	4.99 %	$303,389	$ 7,734	5.10 %
Investment securities	95,753	831	1.74	97,359	820	1.68
Investment securities, tax-free	32,929	358	2.17	18,779	208	2.22
Interest-earning deposits	17,975	77	0.86	17,106	42	0.49
Total interest-earning assets	442,390	8,642	3.91	436,633	8,804	4.03
Noninterest-earning assets	39,919			40,710		
Total assets	$482,309			$477,343		
Liabilities and equity:						
Interest-bearing liabilities:						
NOW and demand deposits	$48,051	$ 30	0.12 %	$49,684	$ 19	0.08 %
Money market deposits	78,284	134	0.34	50,610	67	0.26
Regular savings and other deposits	28,296	19	0.13	25,788	9	0.07
Certificates of deposit	217,306	460	0.42	245,130	489	0.40
Total interest-bearing deposits	371,937	643	0.34	371,212	584	0.31
Total interest-bearing liabilities	371,937	643	0.34	371,212	584	0.31
Noninterest bearing deposits	24,436			21,809		
Other noninterest-bearing liabilities	972			1,969		
Total liabilities	397,345			394,990		
Equity	84,964			82,353		
Total liabilities and equity	$482,309			$477,343		
Net interest income		$ 7,999			$ 8,220	
Interest rate spread			3.57 %			3.72 %
Net interest margin			3.62 %			3.77 %
Average interest-earning assets to average interest-bearing liabilities	1.19 x			1.18 x		

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Comparison of Operating Results for the Three Months Ended December 31, 2016 and December 31, 2015

General. We reported net income of $1.3 million for the three months ended December 31, 2016 compared to $949 thousand for the three months ended December 31, 2015. Interest income decreased $182 thousand for the three months ended December 31, 2016 while interest expense increased $28 thousand resulting in a net decrease to net interest income of $210 thousand. Noninterest income increased $43 thousand for the three months ended December 31, 2016 compared to December 31, 2015 due primarily to gains recognized on the sales of securities available-for-sale and PCI loans. Total noninterest expense decreased $449 thousand due to lower salaries and employee benefits expenses and the net change in the loan servicing asset.

Interest Income. Interest income decreased by $182 thousand, or 4.1%, to $4.2 million for the three months ended December 31, 2016. The yield on interest earning-assets decreased 17 basis points from 4.02% for the three months ended December 31, 2015 to 3.85% for the three months ended December 31, 2016. The decrease was slightly offset by an increase in total average interest-earning assets of $1.1 million to $441.4 million for the three months ended December 31, 2016 from $440.3 million for the three months ended December 31, 2015.

Interest income on loans was $3.6 million for the three months ended December 31, 2016 compared to $3.9 million for the three months ended December 31, 2015. The yield on loans decreased 25 basis points from 5.13% for the three months ended December 31, 2015 to 4.88% for the three months ended December 31, 2016. The average balance of loans also decreased by $2.0 million, or 0.7%, to $298.4 million for the three months ended December 31, 2016 from $300.4 million for the three months ended December 31, 2015. The decrease in the average balance of our loans is reflective of the run-off in the months following the acquisition of Stephens Federal Bank in December 2014. As a result of the acquisition, we obtained loans with slightly higher coupon rates from ours, which had a positive effect of increasing our overall loan portfolio yield.

Interest income on investment securities increased by $19 thousand, or 3.5%, to $568 thousand for the three months ended December 31, 2016 from $549 thousand for the three months ended December 31, 2015. The increase reflected an increase in the average balance of securities of $5.7 million, or 4.7%, to $126.1 million for the three months ended December 31, 2016 from $120.4 million for the three months ended December 31, 2015 offset by a decrease of two basis points in the yield on securities to 1.80% from 1.82%. The increase in the average balances of our investment securities is reflective of our efforts to continue to invest in high-quality investment securities during periods of low loan demand.

The average balance of interest-earning deposits decreased $2.6 million from the three months ended December 31, 2015 to the three months ended December 31, 2015 while the yield increased 32 basis points over the same period.

Interest Expense. Interest expense increased by $28 thousand, or 9.5%, to $323 thousand for the three months ended December 31, 2016 from $295 thousand for the three months ended December 31, 2015. The increase reflected an increase of four basis points in the average rate paid on deposits for the three months ended December 31, 2016 to 0.35% from 0.31% for the three months ended December 31, 2015. The increase in the average rate paid on deposits is reflective of our efforts to keep our cost of funds as low as possible but still maintain our competitiveness in our market area among other banking institutions. Average interest-bearing deposits were $369.8 million for the three months ended December 31, 2016 compared to $376.0 million for the three months ended December 31, 2015.

The largest increase in interest expense related to expense on money market deposits, which increased $23 thousand, or 46.9%, to $72 thousand for the three months ended December 31, 2016 from $49 thousand for the three months ended December 31, 2015. Average money market deposit balances increased $17.1 million from $62.1 million for the three months ended December 31, 2015 to $79.2 million for the three months ended December 31, 2016. The increase resulted from a successful money market campaign during the year ended June 30, 2016.

The average rate paid on certificates of deposit increased from 0.39% at December 31, 2015 to 0.43% for the three months ended December 31, 2016 while average balances decreased from $239.5 million for the three-month period ended December 31, 2015 to $213.9 million for the three-month period ended December 31, 2016. Lower volume resulted in a decrease in interest expense of $1 thousand for certificates of deposit.

The average balance of NOW and demand deposits decreased by $1.7 million while the average rate increased two basis points and the average balance of savings deposits increased $4.1 million and average rates increased four basis points.

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Net Interest Income. Net interest income before the provision for loan losses decreased by $210 thousand, or 5.1%, to $3.9 million for the three months ended December 31, 2016. Our interest rate spread and net interest margin for the three months ended December 31, 2016 decreased to 3.50% and 3.55%, respectively, from 3.71% and 3.75%, respectively, for the three months ended December 31, 2015. The lower yield and lower average balance of loans primarily contributed to the decrease in net interest margin for the three months ended December 31, 2016.

Provision for Loan Losses. We recorded a provision for loan losses of $24 thousand for the three months ended December 31, 2016 compared with $277 thousand for the three months ended December 31, 2015. There were no net charge-offs for the three months ended December 31, 2016 compared to $140 thousand for the three months ended December 31, 2015. Primarily all of the charge-offs for the three months ended December 31, 2015 were related to loans we acquired. The lower provision is due to lower net charge-offs, a smaller balance of PCI loans and the length of time that the PCI loans have been on the books.

Our total allowance for loan losses was $996 thousand, or 0.33%, of total gross loans, at December 31, 2016 and $922 thousand, or 0.32%, of total gross loans at June 30, 2016. The ending allowance for specifically identified impaired loans was $185 thousand at December 31, 2016 compared to $184 thousand at June 30, 2016. The recorded investment in impaired loans at December 31, 2016 was $5.2 million compared to $5.4 million at June 30, 2016. The allowance for specifically identified impaired loans at December 31, 2016 and June 30, 2016 includes an allowance of $151 thousand and $129 thousand, respectively for PCI loans.

The general valuation allowance at December 31, 2016 and June 30, 2016 was $811 thousand and $738 thousand, respectively. Total loans evaluated collectively for impairment increased $9.6 million, or 3.3%, to $296.3 million at December 31, 2016 compared to $286.7 million at June 30, 2016. No general valuation allowance has been recorded for the acquired portion of our loan portfolio that was not determined to be PCI.

To the best of our knowledge, we have recorded all losses that are both probable and reasonably estimable for the three months ended December 31, 2016 and 2015. There have been no changes to our allowance for loan loss methodology.

Noninterest Income. Noninterest income increased $43 thousand, or 9.5%, to $495 thousand for the three months ended December 31, 2016 from $452 thousand for the three months ended December 31, 2015. Gains on the disposition of PCI loans of $120 thousand were recognized for the three months ended December 31, 2016 compared to $90 thousand for the three months ended December 31, 2015. Gains on sales of investment securities available for sale were $57 thousand for the three months ended December 31, 2016. There were no gains on sales of investment securities for the three months ended December 31, 2015. Gains on sales of securities are largely market driven, as we generally have no need to sell securities and would only expect to do so if a gain will be realized. Service charges and mortgage banking income declined for comparable periods as a result of decreased activity.

Noninterest Expense. Noninterest expense for the three months ended December 31, 2016 decreased by $449 thousand, or 15.5%, to $2.5 million from $2.9 million for the same period in 2015. Salaries and employee benefits decreased $228 thousand from $1.9 million for the three months ended December 31, 2015 to $1.6 million for the three months ended December 31, 2016 due to decreases in the discretional contributions to the ESOP and profit sharing plans in 2016.

When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value. These servicing rights are then measured at each reporting date and changes are recorded as “change in loan servicing asset” on the consolidated statements of income and comprehensive income. For the three months ended December 31, 2016, we recognized income for the increase in the loan servicing asset of $196 thousand compared to an expense of $21 thousand for the three months ended December 31, 2015. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Expenses related to foreclosed assets decreased from $47 thousand for the three months ended December 31, 2015 to $2 thousand for the three months ended December 31, 2016. Expenses related to foreclosed assets for the three months ended December 31, 2015 included a provision for potential losses of $15 thousand. There were also more properties held in real estate owned at December 31, 2015 compared to December 31, 2016 resulting in higher expenses. Real estate owned is carried at the lower of its carrying value or fair value, less costs to sell. We typically do not experience large gains or losses on real estate properties sold.

Income Tax Expense. Income tax expense for the three months ended December 31, 2016 was $618 thousand compared with $452 thousand for the three months ended December 31, 2015. Our effective income tax rate was 31.9% and 32.3% for the same periods, respectively. The slight decrease in our effective tax rate is primarily due to a higher volume of tax-free investment securities.

Comparison of Operating Results for the Six Months Ended December 31, 2016 and December 31, 2015

General. We reported net income of $2.6 million for the six months ended December 31, 2016 compared to $2.4 million for the six months ended December 31, 2015. Interest income decreased $162 thousand for the six months ended December 31, 2016 while interest expense increased $59 thousand resulting in a net decrease to net interest income of $221 thousand. A provision for loan losses of $89 thousand was recognized for the six months ended December 31, 2016 compared to $422 thousand for the six months ended December 31, 2015. Noninterest income decreased $545 thousand for the six months ended December 31, 2016 compared to December 31, 2015 primarily due to a reduction in gains recognized on the disposition of PCI loans. Total noninterest expense decreased $629 thousand as a result of decreased foreclosed asset expenses, lower salaries and employee benefits and the change in the loan servicing asset.

Interest Income. Interest income decreased by $162 thousand, or 1.8%, to $8.6 million for the six months ended December 31, 2016. The yield on interest earning-assets decreased twelve basis points from 4.03% for the six months ended December 31, 2015 to 3.91% for the six months ended December 31, 2016. The decrease was slightly offset by an increase in total average interest-earning assets of $5.8 million to $442.4 million for the six months ended December 31, 2016 from $436.6 million for the six months ended December 31, 2015.

Interest income on loans was $7.4 million for the six months ended December 31, 2016 compared to $7.7 million for the six months ended December 31, 2015. The yield on loans decreased 11 basis points from 5.10% for the six months ended December 31, 2015 to 4.99% for the six months ended December 31, 2016, and the average balance of loans decreased by $7.7 million, or 2.5%, to $295.7 million for the six months ended December 31, 2016 from $303.4 million for the six months ended December 31, 2015. The decrease in the average balance of our loans is reflective of the run-off in the months following the acquisition of Stephens Federal Bank in December 2014. As a result of the acquisition, we obtained loans with slightly higher coupon rates from ours, which had a positive effect of increasing our overall loan portfolio yield.

Interest income on investment securities increased by $161 thousand, or 15.7%, to $1.2 million for the six months ended December 31, 2016 from $1.0 million for the six months ended December 31, 2015. The increase reflected an increase in the average balance of securities of $12.6 million, or 10.9%, to $128.7 million for the six months ended December 31, 2016 from $116.1 million for the six months ended December 31, 2015 and an increase of eight basis points in the yield on securities to 1.85% from 1.77%. The increase in the average balances of our investment

securities is reflective of our efforts to continue to invest in high-quality investment securities during periods of low loan demand. The increase in the yield on our investment securities is reflective of our efforts to shift our portfolio concentration to investments in municipal securities, which give us slightly higher yields and in some cases provide tax-exempt income.

Interest Expense. Interest expense increased by $59 thousand, or 10.1%, to $643 thousand for the six months ended December 31, 2016 from $584 thousand for the six months ended December 31, 2015. The increase reflected an increase of three basis points in the average rate paid on deposits for the six months ended December 31, 2016 to 0.34% from 0.31% for the six months ended December 31, 2015. The increase in the average rate paid on deposits is reflective of our efforts to keep our cost of funds as low as possible but still maintain our competitiveness in our market area among other banking institutions. Average interest-bearing deposits were $371.9 million for the six months ended December 31, 2016 compared to $371.2 million for the six months ended December 31, 2015.

The largest increase in interest expense related to expense on money market deposits, which increased $67 thousand, or 100.0%, to $134 thousand for the six months ended December 31, 2016 from $67 thousand for the six months ended December 31, 2015. Average money market deposit balances increased $27.7 million from $50.6 million for the six months ended December 31, 2015 to $78.3 million for the six months ended December 31, 2016. The increases resulted from a successful money market campaign during the year ended June 30, 2016.

The average rate paid on certificates of deposit was 0.42% for the six months ended December 31, 2016 compared to 0.40% for the six months ended December 31, 2015. Average balances decreased from $245.1 million for the six-month period ended December 31, 2015 to $217.3 million for the six-month period ended December 31, 2016. Lower volume resulted in a decrease in interest expense of $29 thousand for certificates of deposit.

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The average balance of NOW and demand deposits decreased by $1.6 million while the average rate increased four basis points and the average balance of savings deposits increased $2.5 million and the average rate increased six basis points.

Net Interest Income. Net interest income before the provision for loan losses decreased by $221 thousand, or 2.7%, to $8.0 million for the six months ended December 31, 2016. Our interest rate spread and net interest margin for the six months ended December 31, 2016 decreased to 3.57% and 3.62%, respectively, from 3.72% and 3.77%, respectively, for the six months ended December 31, 2015. Average loan volume, which has the highest yield, decreased by $7.7 million, significantly contributing to the decrease in net interest margin for the six months ended December 31, 2016.

Provision for Loan Losses. We recorded a provision for loan losses of $89 thousand for the six months ended December 31, 2016 compared with $422 thousand for the six months ended December 31, 2015. Net charge-offs for the six months ended December 31, 2016 were $15 thousand compared to $282 thousand for the six months ended December 31, 2015. Primarily all of the charge-offs for the six months ended December 31, 2016 and 2015 were related to loans we acquired. The lower provision is due to lower net charge-offs, a smaller balance of PCI loans and the length of time that the PCI loans have been on the books.

Our total allowance for loan losses was $996 thousand, or 0.33%, of total gross loans, at December 31, 2016 and $922 thousand, or 0.32%, of total gross loans at June 30, 2016. The ending allowance for specifically identified impaired loans was $185 thousand at December 31, 2016 compared to $184 thousand at June 30, 2016. The recorded investment in impaired loans at December 31, 2016 was $5.2 million compared to $5.4 million at June 30, 2016. The allowance for specifically identified impaired loans at December 31, 2016 and June 30, 2016 includes an allowance of $151 thousand and $129 thousand, respectively for PCI loans.

The general valuation allowance at December 31, 2016 and June 30, 2016 was $811 thousand and $738 thousand, respectively. Total loans evaluated collectively for impairment increased $9.6 million, or 3.3%, to $296.3 million at December 31, 2016 compared to $286.7 million at June 30, 2016. No general valuation allowance has been recorded for the acquired portion of our loan portfolio that was not determined to be PCI.

To the best of our knowledge, we have recorded all losses that are both probable and reasonably estimable for the six months ended December 31, 2016 and 2015. There have been no changes to our allowance for loan loss methodology.

Noninterest Income. Noninterest income decreased $545 thousand, or 36.1%, to $963 thousand for the six months ended December 31, 2016 from $1.5 million for the six months ended December 31, 2015. Gains on the disposition of PCI loans of $809 thousand were recognized for the six months ended December 31, 2015 compared to $196 thousand

for the six months ended December 31, 2016. Gains on sales of investment securities available for sale increased from $9 thousand for the six months ended December 31, 2015 to $125 thousand for the six months ended December 31, 2016. Gains on sales of securities are largely market driven, as we generally have no need to sell securities and would only expect to do so if a gain will be realized.

Noninterest Expense. Noninterest expense for the six months ended December 31, 2016 decreased by $629 thousand, or 11.1%, to $5.0 million from $5.7 million for the same period in 2015. Expenses related to foreclosed assets decreased from $222 thousand for the six months ended December 31, 2015 to $37 thousand for the six months ended December 31, 2016. Total expenses related to foreclosed assets were offset by net gains realized on sales of real estate owned of $86 thousand for the six months ended December 31, 2016. A net loss of $69 thousand was recognized on sales of real estate owned for the six months ended December 31, 2015. There were also more properties held in real estate owned at December 31, 2015 compared to December 31, 2016 resulting in higher expenses. Real estate owned is carried at the lower of its carrying value or fair value, less costs to sell. We typically do not experience large gains or losses on real estate properties sold.

When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value. These servicing rights are then measured at each reporting date and changes are recorded as “change in loan servicing asset” on the consolidated statements of income and comprehensive income. For the six months ended December 31, 2016, we recognized income for the increase in the loan servicing asset of $173 thousand compared to an expense of $86 thousand for the six months ended December 31, 2015. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Salaries and employee benefits decreased $205 thousand from the six months ended December 31, 2015 to the six months ended December 31, 2016 due to decreases in the discretional contributions to the ESOP and profit sharing plans in 2016.

Income Tax Expense. Income tax expense for both the six month periods ended December 31, 2016 and 2015 was $1.2 million. Our effective income tax rate was 32.2% and 34.1% for the same periods, respectively. The decrease in our effective tax rate is primarily due to a higher volume of tax-free investment securities.

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.

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 (i) expected loan demand, (ii) expected deposit flows, (iii) yields available on interest-earning deposits and investment securities, and (iv) the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest-earning overnight deposits, federal funds sold, and short and intermediate-term U.S. Government sponsored agencies and mortgage-backed securities of short duration. If we require funds beyond our ability to generate them internally, we have credit available under a loan agreement with the Federal Home Loan Bank of Atlanta in the amount of 25% of total assets (as of December 31, 2016), or approximately $120.6 million.

Common Stock Dividends. On August 25, 2016 and November 25, 2016, the Company paid a $0.10 per share cash dividend on its common stock for a total of $1.1 million.

Equity Compensation Plans. During the three months ended December 31, 2016, no shares of restricted stock or stock options were issued to management.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Disclosures of quantitative and qualitative market risk are not required by smaller reporting companies, such as the Company.

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of December 31, 2016. Based on that evaluation, the Company’s management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Company’s disclosure controls and procedures were effective.

During the quarter ended December 31, 2016, there have been no changes in the Company’s internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities and Exchange Act of 1934, amended) that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

There are various claims and lawsuits in which the Company is periodically involved incidental to the Company’s business. In the opinion of management, no material loss is expected from any of such pending claims or lawsuits.

ITEM 1A. RISK FACTORS

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

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) None.

(b) Not applicable.

(c) ***Issuer Repurchases.*** On November 24, 2015, the Board of Directors authorized the repurchase of up to 175,000 of the Company's common stock, which represents approximately 10.2% of the Company's issued and outstanding shares (excluding shares that Oconee Federal, MHC currently holds).

In connection with the authorization of this stock repurchase program, the Board of Directors terminated the Company's existing stock repurchase program, which had authorized the Company to purchase up to 150,000 shares of its issued and outstanding common stock. The Company had previously purchased a total of 113,400 shares of its common stock at a weighted average price of $16.04 per share under the existing stock repurchase program.

The following table sets forth information in connection with repurchases of the Company's common stock for the period October 1, 2016 through December 31, 2016.

	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
October 1 - October 31, 2016	-	$ -	-	89,169
November 1 - November 30, 2016	2,315	23.05	2,315	86,854
December 1 - December 31, 2016	1,029	23.05	1,029	85,825 (2)
Total	3,344	$ 23.05	3,344 (1)	

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

(2) Represents the maximum number of shares available for repurchase under the November 24, 2015 plan at December 31, 2016.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The exhibits required by Item 601 of Regulation S-K are included with this Form 10-Q and are listed in the "Index to Exhibits" immediately following the Signatures.

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SIGNATURES

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

Oconee Federal Financial Corp.

Date: February 10, 2017

/s/ Curtis T. Evatt
Curtis T. Evatt
President, Chief Executive Officer and Chief Financial Officer

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INDEX TO EXHIBITS

Exhibit number	Description
10.1	Amended and Restated Employment Agreement by and between Oconee Federal Savings and Loan Association, Oconee Federal Financial Corp. and T. Rhett Evatt
10.2	Amended and Restated Employment Agreement by and between Oconee Federal Savings and Loan Association, Oconee Federal Financial Corp. and Curtis T. Evatt
31	Certification of Curtis T. Evatt, President, Chief Executive Officer and Chief Financial Officer, Pursuant to Rule 13a-14(a) and Rule 15d-14(a).
32	Certification of Curtis T. Evatt, President, Chief Executive Officer and Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2016, formatted in XBRL (Extensible Business Reporting Language):

(i) Consolidated Balance Sheets
(ii) Consolidated Statements of Income and Comprehensive Income
(iii) Consolidated Statements of Changes In Shareholders' Equity
(iv) Consolidated Statements of Cash Flows, and
(v) Notes to The Consolidated Financial Statements