Moving forward.

2012 ANNUAL REPORT

WATERSTONE FINANCIAL, INC.

Letter to Shareholders

2012 will be remembered as one of the best years in WaterStone's 91 year history.

WaterStone continues to improve its regulatory status and was released from its consent order with the FDIC in December. We are now positioned for future growth after strategically shrinking the bank the last few years.

Along with record profits, we were able to reduce our problem assets as exemplified by these year over year reductions:

- Delinquent loans declined by 20%; and early delinquency (<90 days delinquent) was reduced by 37%
- Non-performing assets declined 18%
- Real Estate Owned went from $56.7 million to $36.0 million, a 36.5% decline
- Net loan charge-offs were $18.8 million in 2011 and $9.7 million in 2012, a 48% decline

We remain committed to serving and supporting the community as evidenced by our Foundation's charitable donations of over $560,000 in 2012 reaching nearly 275 different non-profits and schools. Our "Celebrating 90 years with $90,000" campaign earned the PRSA Paragon Award of Merit in Community Relations and PR News Corporate Social Responsibility Award Finalist for Workplace Innovation.

We strongly believe that motivated employees provide exceptional customer service which leads to stockholder value. Based on a survey of all our employees, we have been awarded a Top 100 Workplace in Southeastern Wisconsin for the third straight year. Additionally, our West Allis Branch was voted 2011 West Allis Business of the Year by the West Allis West Milwaukee Chamber of Commerce.

WaterStone Mortgage Corp, our mortgage banking subsidiary, has continued to grow and provide excellent returns. Their contribution has enabled us to return to profitable operations.

2012 results have now given us a platform to build upon. On behalf of our Board, management team, and employees, we thank you for your patience, loyalty and trust.

Respectfully,

Doug Gordon

Douglas Gordon
President/CEO

Recognitions:

- PRSA Paragon Award of Merit in the Community Relations category for "Celebrating 90 Years With $90,000"
- PR News' CSR (Corporate Social Responsibility) Award Finalist for Workplace Innovation (Celebrating 90 Years With $90,000)
- Named West Allis 2011 Business of the Year in March 2012
- Top 100 Workplaces in Southeastern Wisconsin (3rd year in a row)
- WI Association of School Boards' 2012 Business Honor Roll Recipient for our support of the Elmbrook Education Foundation
- Charitable Giving Stats – over $560,000 donated to nearly 275 schools and nonprofits.

Waterstone
FINANCIAL, INC.

April 1, 2013

Dear Fellow Shareholder,

We invite you to attend the Waterstone Financial, Inc. Annual Meeting of Shareholders, which will be held at WaterStone Bank SSB, 11200 W. Plank Ct., Wauwatosa, Wisconsin at 9:00 a.m., Central Time, on Tuesday, May 21, 2013.

We are once again furnishing proxy materials to our shareholders over the internet, as permitted by rules adopted by the Securities and Exchange Commission. You may read, print and download our 2012 Annual Report to Shareholders on Form 10-K and our Proxy Statement at www.proxyvote.com. On April 1, 2013, we mailed our shareholders a notice containing instructions on how to access these materials and how to vote their shares online. The notice provides instructions on how you can request a paper copy of these materials by mail, by telephone or by e-mail. If you requested your materials via e-mail, the e-mail contains voting instructions and links to the materials on the internet.

You may vote your shares by internet, by telephone, by regular mail or in person at the Annual Meeting. Instructions regarding the various methods of voting are contained on the notice and on the Proxy Card.

The proxy materials describe the formal business to be transacted at the Annual Meeting. Included in the materials is our Annual Report on Form 10-K, which contains detailed information concerning our activities and operating performance.

On behalf of the Board, we request that you vote your shares now, even if you currently plan to attend the Annual Meeting. This will not prevent you from voting in person, but will assure that your vote is counted.

Sincerely,

Doug Gordon

DOUGLAS S. GORDON
Chief Executive Officer

WATERSTONE FINANCIAL, INC.

11200 W. Plank Ct.
Wauwatosa, Wisconsin 53226
(414) 761-1000

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD ON MAY 21, 2013

To the Shareholders of Waterstone Financial, Inc.:

The 2013 annual meeting of shareholders of Waterstone Financial, Inc. will be held on Tuesday, May 21, 2013, at 9:00 a.m., Central Time, at WaterStone Bank SSB, 11200 W. Plank Ct., Wauwatosa, Wisconsin for the following purposes:

(1) Electing one director to serve for a term expiring in 2016;
(2) An advisory, non-binding resolution to approve to the executive compensation described in the Proxy Statement;
(3) Ratifying the selection of KPMG LLP as Waterstone Financial, Inc.'s independent registered public accounting firm; and
(4) Transacting such other business as may properly come before the annual meeting or any adjournment thereof.

The board of directors has fixed the close of business on March 25, 2013 as the record date for the determination of shareholders entitled to notice of and to vote at the annual meeting and any adjournment thereof. Only shareholders of record at the close of business on that date will be entitled to vote at the annual meeting. Lamplighter Financial, MHC, our mutual holding company, owns 74% of our outstanding shares and intends to vote its shares in favor of the proposals described in this Proxy Statement.

We call your attention to the Proxy Statement accompanying this notice for a more complete statement regarding the matters to be acted upon at the annual meeting. Please read it carefully.

By Order of the Board of Directors

William F. Bruss
Senior Vice President and Secretary

Wauwatosa, Wisconsin
April 1, 2013

PROXY STATEMENT

WATERSTONE FINANCIAL, INC.
11200 W. Plank Ct.
Wauwatosa, Wisconsin 53226
(414) 761-1000

SOLICITATION AND VOTING

This Proxy Statement and accompanying Proxy Card are furnished to the shareholders of Waterstone Financial, Inc. ("Waterstone Financial" or the "Company") in connection with the solicitation of proxies by the Waterstone Financial board of directors for use at the annual meeting of shareholders on Tuesday, May 21, 2013, and at any adjournment of the meeting. The 2012 Annual Report on Form 10-K is attached to the Proxy Statement and contains business and financial information concerning us. Our proxy materials are being made available to shareholders on or about April 1, 2013.

Record Date and Meeting Information. The board of directors has fixed the close of business on March 25, 2013 as the record date for the determination of shareholders entitled to notice of and to vote at the annual meeting and any adjournment thereof. Only holders of record of our common stock, the only class of voting stock of Waterstone Financial outstanding, on the record date are entitled to notice of and to vote at the annual meeting. Each share of common stock is entitled to one vote. At the record date, there were 31,348,556 shares of common stock issued and outstanding.

The board of directors of Waterstone Financial knows of no matters to be acted upon at the annual meeting other than as set forth in the notice attached to this Proxy Statement. If any other matters properly come before the annual meeting, or any adjournment thereof, it is the intention of the persons named in the proxy to vote such proxies in accordance with their best judgment on such matters.

Voting Your Shares. Any shareholder entitled to vote at the annual meeting may vote either in person, by a properly executed proxy or online as described in the notice to shareholders and the proxy card. Shares represented by properly executed proxies received by Waterstone Financial will be voted at the annual meeting, or any adjournment thereof, in accordance with the terms of such proxies, unless revoked. **Where no instructions are indicated, validly executed proxies will be voted "FOR" the proposals set forth in this Proxy Statement for consideration at the Annual Meeting.**

A shareholder may revoke a proxy at any time prior to the time when it is voted by filing a written notice of revocation with our corporate secretary at the address set forth above, by delivering a properly executed proxy bearing a later date, using the internet or telephone voting options explained on the Proxy Card, or by voting in person at the annual meeting. Attendance at the annual meeting will not in itself constitute revocation of a proxy. If you are a shareholder whose shares are not registered in your name, you will need appropriate documentation from your record holder in order to vote in person at the annual meeting.

Shares in Employee Plans. Any shareholder who owns shares through an allocation to that person's account under the WaterStone Bank Employee Stock Ownership Plan (the "ESOP") will receive a separate Proxy Card to instruct the ESOP's Trustee how to vote those shares. The ESOP Trustee, BMO Harris Bank N.A., will vote shares allocated to that person's ESOP account in accordance with the participant's instructions. The ESOP administrator may vote, in its discretion, unallocated ESOP shares and any allocated ESOP shares which are not voted by the individuals to whom they are allocated. It is expected that those shares will be voted for all nominees and proposals.

Shares Held by Charitable Foundation. Under applicable regulations and the terms of the Plan of Reorganization pursuant to which WaterStone Bank (the "Bank") converted into the mutual holding company form, the Waukesha County Community Foundation, Inc. must vote all shares of Waterstone Financial common stock held by it in the same ratio as all other shares of Waterstone Financial voted on each proposal by Waterstone Financial shareholders. On the record date, the Waukesha County Community Foundation held 19,334 shares of Waterstone Financial common stock.

Quorum and Required Vote. A majority of the votes entitled to be cast by the shares entitled to vote, represented in person or by proxy, will constitute a quorum of shareholders at the annual meeting. Shares for which authority is withheld to vote for director nominees and broker non-votes (i.e., proxies from brokers or nominees indicating that such persons have not received instructions from the beneficial owners or other persons entitled to vote shares as to a matter with respect to which the brokers or nominees do not have discretionary power to vote) will be considered present for purposes of establishing a quorum. The inspector of election appointed by the board of directors will count the votes and ballots at the annual meeting.

As to the election of directors, shareholders may vote "FOR" or "WITHHELD" as to each or all of the nominees. A plurality of the votes cast at the annual meeting by the holders of shares of common stock entitled to vote is required for the election of directors. In other words, the individuals who receive the largest number of votes are elected as directors up to the maximum number of directors in a class to be chosen at the annual meeting. With respect to the election of directors, any shares not voted, whether by withheld authority, broker non-vote or otherwise, will have no effect on the election of directors except to the extent that the failure to vote for an individual results in another individual receiving a comparatively larger number of votes.

As to the ratification of auditors, shareholders may vote "FOR", "Against" or may "ABSTAIN" from voting on the matter. The affirmative vote of a majority of shareholders present at the annual meeting in person or by proxy is required to ratify KPMG, LLP as our independent registered public accounting firm for the year ending December 31, 2013, without regard to broker non-votes or proxies marked "ABSTAIN".

As to the advisory, non-binding resolution to approve our executive compensation as described in this Proxy Statement, a shareholder may: (i) vote "FOR" the resolution; (ii) vote "AGAINST" the resolution; or (iii) "ABSTAIN" from voting on the resolution. The affirmative vote of a majority of the votes cast at the Annual Meeting, without regard to either broker non-votes, or shares as to which the "ABSTAIN" box has been selected on the proxy card, is required for the approval of this non-binding resolution. While this vote is required by law, it will neither be binding on Waterstone Financial, Inc. or the board of directors, nor will it create or imply any change in the fiduciary duties of, or impose any additional fiduciary duty on Waterstone Financial, Inc. or the board of directors.

Lamplighter Financial MHC owns 74% of the outstanding shares of Waterstone Financial common stock. Lamplighter Financial MHC intends to vote all of its shares in favor of the proposals which means that passage of all items is assured.

Expenses and Solicitation. We will pay expenses in connection with the solicitation of proxies. Proxies will be solicited principally by mail, but may also be solicited by our directors, officers and other employees in person or by telephone, facsimile or other means of communication. Those directors, officers and employees will receive no compensation therefor in addition to their regular compensation, but may be reimbursed for their related out-of-pocket expenses. Brokers, dealers, banks, or their nominees, who hold common stock on behalf of another will be asked to send proxy materials and related documents to the beneficial owners of such stock, and we will reimburse those persons for their reasonable expenses.

BENEFICIAL OWNERSHIP OF COMMON STOCK

The following table provides the beneficial ownership of shares of common stock of Waterstone Financial held by our directors and executive officers, individually and as a group, and all individuals known to management to own more than 5% of our common stock as of March 25, 2013.

Name of Beneficial Owner	Total Shares Beneficially Owned [(1)(2)]	Percent of All Common Stock Outstanding
Rebecca M. Arndt..................................	61,828	*
William F. Bruss....................................	105,958	*
Thomas E. Dalum..................................	98,351	*
Eric J. Egenhofer	49,635	*
Douglas S. Gordon	434,511	1.39%
Michael L. Hansen.................................	240,844	*
Richard C. Larson..................................	130,009	*
Patrick S. Lawton	201,953	*
Stephen J. Schmidt	76,500	*
All directors and executive officers as a group (9 persons) [(3)]............................	1,551,892	4.95%
Lamplighter Financial, MHC................. 11200 West Plank Court Wauwatosa, Wisconsin 53226	23,050,183	73.5%

* Less than 1%.

(1) Unless otherwise noted, the specified persons have sole voting and dispositive power as to the shares. Number of shares identified as indirect beneficial ownership with shared voting and dispositive power: Ms. Arndt – 10,440; Mr. Bruss – 19,458; Mr. Dalum – 23,351; Mr. Gordon – 35,882; Mr. Hansen – 170,000; Mr. Larson – 21,509; Mr. Lawton – 19,600; group – 452,543. See also note (3) below.

(2) Includes the following shares underlying options which are exercisable within 60 days of March 25, 2013: Mr. Egenhoefer – 20,000; Ms. Arndt – 29,000; Messrs. Dalum, Hansen, Lawton and Schmidt – 50,000 shares each; Mr. Larson – 56,000; Mr. Bruss – 57,000; Mr. Gordon – 250,000; all directors and executive officers as a group – 612,000.

(3) The total for the group (but not any individual) includes 152,303 unallocated shares held in the employee stock ownership plan, as to which voting and dispositive power is shared. As administrator, WaterStone Bank (through its board) may vote, in its discretion, shares which have not yet been allocated to participants. Participants may vote the shares allocated to their accounts; the administrator will vote unvoted shares in its discretion. Allocated shares are included only if allocated to named executive officers, in which case they are included in those individuals' (and the group's) beneficial ownership.

The above beneficial ownership information is based on data furnished by the specified persons and is determined in accordance with Rule 13d-3 under the Securities Exchange Act, as required for purposes of this Proxy Statement. It is not necessarily to be construed as an admission of beneficial ownership for other purposes.

PROPOSAL 1 – THE ELECTION OF DIRECTORS

The charter provides that the number of directors of Waterstone Financial, Inc. shall be between five and 15, as determined by the board of directors and set forth in our bylaws. At each annual meeting the term of office of one class of directors expires and a class of directors is elected to serve for a term of three years and until their successors are elected and qualified. Mr. Dalum, the director whose term expires at the annual meeting, is being nominated for re-election as a director for a term expiring in 2016. Shares represented by proxies will be voted FOR the election of the nominee unless otherwise specified by the executing shareholder. If the nominee declines or is unable to act as a director, which we do not foresee, proxies may be voted with discretionary authority for a substitute nominee designated by the board.

Information regarding the nominee and the directors whose terms continue is set forth in the following table. The board of directors unanimously recommends that shareholders vote FOR the election of the director nominee listed below.

Name and Age	Principal Occupation and Business Experience [(1)]	Director Since [(2)]
	Nominee for Term expiring in 2016	
Thomas E. Dalum, 72 (4)(5)(6)	Former chairman and CEO of UELC, an equipment leasing company and of DUECO, an equipment manufacturer and distributor. Mr. Dalum brings a strong entrepreneurial background, an outstanding history of community involvement and public service plus more than 30 years of experience as a member of the Waterstone Financial board of directors. Mr. Dalum has a B.A. from the University of Notre Dame and an M.B.A. from Northwestern University.	1979
	Continuing Directors - Terms expiring in 2015	
Douglas S. Gordon, 55	Chief Executive Officer and President of Waterstone Financial and WaterStone Bank since January 2007; President and Chief Operating Officer of WaterStone Bank prior to 2007 and beginning in 2005; Real estate investor. Mr. Gordon brings extensive prior banking experience as an executive officer at M&I Bank and at Security Savings Bank. He has extensive firsthand knowledge and experience with the Company's lending markets and its customers. Mr. Gordon has a B.A. from the University of Wisconsin – Parkside and an M.B.A. from Marquette University.	2005
Patrick S. Lawton, 56 (3)(4)(5)(6)	Managing Director of Fixed Income Capital Markets for Robert W. Baird & Co., Incorporated. As an R.W. Baird Managing Director, Mr. Lawton brings his investment portfolio expertise to the board of directors. Mr. Lawton has a B.S.B.A. and an M.B.A. from Marquette University.	2000
	Continuing Directors - Terms expiring in 2014	
Michael L. Hansen, 61 (4)(5)(6)	Business investor; current significant ownership interest in Jacsten Holdings LLC, Mid-States Contracting, Inc., and Midwest Metals LLC. In addition to extensive entrepreneurial experience, Mr. Hansen is a C.P.A. with 13 years of audit and tax experience at an international public accounting firm. Mr. Hansen brings this experience to the board of directors and to the audit committee in particular. Mr. Hansen has a B.B.A. from the University of Notre Dame.	2003
Stephen J. Schmidt, 51 (4)(5)(6)	President of Schmidt and Bartelt Funeral and Cremation Services. Mr. Schmidt has solid entrepreneurial experience and extensive community contact throughout the communities served by WaterStone Bank. Mr. Schmidt has an Associates Degree from the New England Institute and a B.A. from the University	2002

of Wisconsin – Stevens Point.

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(1) Unless otherwise noted, all directors have been employed in their respective principal occupations listed for at least the past five years.
(2) Indicates the date when director was first elected to the board of WaterStone Bank. Each of these persons became a director of Waterstone Financial in 2005.
(3) Chairman of the Board and of WaterStone Bank, effective January 1, 2007.
(4) Member of the Compensation Committee, of which Mr. Lawton is Chairman.
(5) Member of the Nominating Committee, of which Mr. Schmidt is Chairman.
(6) Member of the Audit Committee, of which Mr. Hansen is Chairman.

Information regarding named executive officers who are not directors of Waterstone Financial is set forth in the following table. Each of these individuals has held the position listed below for at least the past five years.

Name and Age	Offices and Positions with Waterstone Financial and WaterStone Bank	Executive Officer Since
Richard C. Larson, 56	Chief Financial Officer and Senior Vice President of Waterstone Financial and of WaterStone Bank	1990
William F. Bruss, 43	General Counsel, Senior Vice President and Secretary of Waterstone Financial and of WaterStone Bank	2005
Rebecca M. Arndt, 45	Vice President – Retail Operations of WaterStone Bank previously First Vice President, Retail Banking at Ozaukee Bank	2006
Eric J. Egenhoefer, 37	President of Waterstone Mortgage Corporation	2008

Board Meetings and Committees

The Waterstone Financial board of directors met eight times during the year ended December 31, 2012 on behalf of Waterstone Financial and an additional 12 times in their capacity as directors of WaterStone Bank. The board of directors consists of a majority of "independent directors" within the meaning of the NASDAQ corporate governance listing standards. The board of directors has determined that Messrs. Dalum, Hansen, Lawton and Schmidt are "independent" directors within the meaning of such standards. In evaluating the independence of our independent directors, we found no transactions between us and our independent directors that are required to be reported in this Proxy Statement and that had an impact on our determination as to the independence of our directors. Therefore, all members of the Audit, Compensation and Nominating Committees are "independent." As part of their meetings, independent directors regularly met without management or non-independent directors present. Directors attended all meetings of the board and meetings of the committees of the board on which such director served during the year with two exceptions. Mr. Lawton was excused from an Audit Committee meeting on March 6, 2012 and Mr. Dalum was excused from the WaterStone Bank board meeting and the Audit Committee meeting both on February 21, 2012.

The Audit Committee met eight times during the year ended December 31, 2012. The board of directors has determined that each member of the Audit Committee meets not only the independence requirements applicable to the committee as prescribed by the NASDAQ corporate governance listing standards, but also by the Securities and Exchange Commission. On behalf of the Audit Committee, Mr. Hansen, its chair, also regularly consults with the Waterstone Financial independent registered public accounting firm about the Waterstone Financial periodic public financial disclosures. The board believes that all of the members of the Audit Committee have sufficient experience, knowledge and other personal qualifications to be "financially literate" and to be active, effective and contributing members of the Audit Committee. Mr. Hansen has been designated an "audit committee financial expert" pursuant to the Sarbanes-Oxley Act of 2002 and the Securities and Exchange Commission regulations. See also "Report of the Audit Committee" for other information pertaining to the Audit Committee.

The Compensation Committee, chaired by Mr. Lawton, held four meetings during the year ended December 31, 2012. Each member of the Compensation Committee is considered independent as defined in the NASDAQ corporate governance listing standards. The Compensation Committee has the responsibility for and authority to either establish or recommend to the board: compensation policies and plans; salaries, bonuses and benefits for all officers; salary and benefit levels for employees; determinations with respect to stock options and restricted stock awards; and other personnel policies and procedures. The Compensation Committee has the authority to delegate the development, implementation and execution of benefit plans to management. See also "Compensation Discussion and Analysis" and "Compensation Committee Interlocks and Insider Participation" for other information pertaining to the Compensation Committee.

The Nominating and Corporate Governance Committee, chaired by Mr. Schmidt, held one meeting during the year ended December 31, 2012. Each member of the nominating committee is considered "independent" as defined in the NASDAQ corporate governance listing standards. Our board of directors has adopted a written charter for the nominating committee.

The functions of the nominating committee include the following:

- to lead the search for individuals qualified to become members of the board of directors and to select director nominees to be presented for shareholder approval;
- to review and monitor compliance with the requirements for board independence;
- to review the committee structure and make recommendations to the board of directors regarding committee membership; and
- to develop and recommend to the board of directors for its approval a set of corporate governance guidelines.

The nominating committee identifies nominees by first evaluating the current members of the board of directors willing to continue in service. Current members of the board of directors with skills and experience that are relevant to our business and who are willing to continue in service are first considered for re-nomination, balancing the value of continuity of service by existing members of the board of directors with that of obtaining a new perspective. If any member of the board of directors does not wish to continue in service, or if the committee or the Board decides not to re-nominate a member for re-election, or if the size of the board of directors is increased, the nominating committee would solicit suggestions for director candidates from all board members.

Qualifications of director candidates are described in the Appendix to the Nominating and Corporate Governance Committee Charter. Factors considered include strength of character, honesty and integrity, an inquiring and independent mind, judgment, skill, diversity, education, experience with businesses and other organizations, the interplay of the candidates' experience with the experience of other board members and the extent to which the candidate would be a desirable addition to the board and its committees. Nominees must have a background which demonstrates an understanding of business and financial affairs and the complexities of a business organization. Although a career in business is not essential, the nominee should have a proven record of competence and accomplishments through leadership in industry, education, the professions or government. Areas of core competency that should be represented on the board as a whole include accounting and finance, business judgment, management, crisis response, industry knowledge, leadership and strategic vision.

The nominating committee will also take into account whether a candidate satisfies the criteria for "independence" under the NASDAQ corporate governance listing standards and, if a nominee is sought for service on the audit committee, the financial and accounting expertise of a candidate, including whether an individual qualifies as an "audit committee financial expert."

The Nominating and Corporate Governance Committee will consider proposed nominees whose names are submitted to it by shareholders, and it does not intend to evaluate proposed nominees differently depending upon who has made the proposal. Shareholders can submit the names of qualified candidates for director by writing to our Corporate Secretary at 11200 W Plank Ct, Wauwatosa, WI 53226. The Corporate Secretary must receive a submission not more than 110 days and not less than 80 days prior to the date of our next annual meeting. The submission must include the following information:

- a statement that the writer is a shareholder and is proposing a candidate for consideration by the nominating committee;
- the name and address of the shareholder as they appear on our books and number of shares of our common stock that are owned beneficially by such shareholder (if the shareholder is not a holder of record, appropriate evidence of the shareholder's ownership will be required);
- the name, address and contact information for the candidate, and the number of shares of common stock that are owned by the candidate (if the candidate is not a holder of record, appropriate evidence of the shareholder's ownership should be provided);
- a statement of the candidate's business and educational experience;
- such other information regarding the candidate as would be required to be included in the Proxy Statement pursuant to SEC Regulation 14A;
- a statement detailing any relationship between us and the candidate;
- a statement detailing any relationship between the candidate and any of our customers, suppliers or competitors;
- detailed information about any relationship or understanding between the proposing shareholder and the candidate; and
- a statement that the candidate is willing to be considered and willing to serve as a director if nominated and elected.

A nomination submitted by a shareholder for presentation at an annual meeting of shareholders will also need to comply with any additional procedural and informational requirements we may adopt in the future, including those set forth in "Shareholder Proposals and Notices."

Waterstone Financial has adopted charters for the Audit, Compensation and Nominating and Corporate Governance Committees. We will continue to respond to and comply with SEC and NASDAQ Stock Market requirements relating to board committees. Copies of the charters for our Audit, Compensation and Nominating and Corporate Governance Committees (including director selection criteria) and other corporate governance documents can be found on our website, at www.wsbonline.com, on the "Resources" tab under the link "Investor Relations-Corporate Governance." If any of those documents are changed, or related documents adopted, those changes and new documents will be posted on our corporate website at that address.

Other Board and Corporate Governance Matters

Board Leadership Structure and Risk Oversight Role. The role of chairman of the board of directors and chief executive officer/president of the Company are not currently held by the same person. The chairman of the board has never been an officer or employee of the Company or the Bank. The foregoing structure is not mandated by any provision of law or our articles of incorporation or bylaws, but the board of directors currently believes that this structure provides for an appropriate balance of authority between management and the board. The board of directors reserves the right to establish a different structure in the future.

The board of directors of the Company, all of the members of which are also members of the board of directors of the Bank, is actively involved in the Company's and Bank's risk oversight activities, through the work of numerous committees of the Company and Bank, and the policy approval function of the board of directors of the Bank.

Communications between Shareholders and the Board. A shareholder who wants to communicate with the board of directors or with any individual director can write to our Corporate Secretary at 11200 W Plank Ct, Wauwatosa, WI 53226, Attention: Board Administration. The letter should indicate that the author is a shareholder and if shares are not held of record, should include appropriate evidence of stock ownership. Depending on the subject matter, management will:

- forward the communication to the director or directors to whom it is addressed;

- attempt to handle the inquiry directly, i.e. where it is a request for information about us or it is a stock-related matter; or
- not forward the communication if it is primarily commercial in nature, relates to an improper or irrelevant topic, or is unduly hostile, threatening, illegal or otherwise inappropriate.

At each board meeting, management shall present a summary of all communications received since the last meeting that were not forwarded and make those communications available to the directors.

Director Attendance at Annual Shareholders' Meeting. Waterstone Financial expects all of its directors to attend the annual meeting of shareholders. Last year, all directors attended our annual meeting of shareholders.

Code of Ethics. Waterstone Financial has adopted a code of business conduct and ethics that reflects current circumstances and SEC and NASDAQ definitions for such codes. The code of business conduct and ethics covers us, WaterStone Bank and other subsidiaries. Among other things, the code of business conduct and ethics includes provisions regarding honest and ethical conduct, conflicts of interest, full and fair disclosure, compliance with law, and reporting of and sanctions for violations. The code applies to all directors, officers and employees of Waterstone Financial and subsidiaries. We have posted a copy of the code of business conduct and ethics on our corporate website, at www.wsbonline.com, on the "Resources" tab under the link "Investor Relations-Corporate Governance." As further matters are documented, or if those documents (including the code of business conduct and ethics) are changed, waivers from the code of business conduct and ethics are granted, or new procedures are adopted, those new documents, changes and/or waivers will be posted on the corporate website at that address.

COMPENSATION DISCUSSION AND ANALYSIS

Compensation Philosophy. The primary objectives of our executive compensation programs are to attract and retain highly-qualified executives, encourage extraordinary management effort through well-designed incentive opportunities and contribute to the short- and long-term interests of our shareholders. Executive compensation includes base salary, discretionary bonus and equity incentive awards. The programs are intended to reward the accomplishment of strategic plan goals and objectives as evaluated by members of the compensation committee. They are further intended to reward enhanced shareholder value as measured by share price.

Base Salary. In determining the base salary of executive officers, the committee reviewed, among other things, third party surveys of peer institutions, the historical compensation of those officers under review and performance measures of Waterstone Financial and its subsidiaries. The compensation committee's executive base salary review and analysis for 2012 resulted in an 85.7% increase in base salary from 2011 for the Chief Executive Officer. The significant increase was primarily the result of the lack of stock incentives available to replace grants awarded in 2007 that vested in prior years. Total 2011 compensation expense as reported in the audited Waterstone Financial, Inc. consolidated financial statements included Chief Executive Officer stock incentive expense of $604,100. The calendar 2012 average increase for the other named WaterStone Bank executive officers was 1.9%. The compensation committee concluded that the level of base salary did not need to be further raised in order to accomplish the objectives noted above. Base salary for the president of the mortgage banking subsidiary was increased by 23.6% in 2012 based on the subsidiary's 2011 operating performance. The Compensation Committee commissioned Verisight to perform a third-party compensation analysis in 2011 to be used as the basis of for determining both WaterStone Bank executive and director compensation for calendar 2012.

Bonus. Bonus amounts have historically been determined on a discretionary basis following a review of our performance and that of the executive in question. As a result of the net income generated in 2012, the compensation committee awarded bonus compensation to all WaterStone Bank executives. A $350,000 bonus was awarded to the Chief Executive Officer as compensation for significant improvement to operating performance achieved by the Company in 2012. Discretionary bonuses averaging 13.4% of base salary were awarded to other named Bank executives in 2012 in recognition of the significant operating performance achieved by the Company. No bonuses were awarded to named Bank executives in 2011 or 2010. During 2010, the compensation committee established a bonus formula for the President of Waterstone Mortgage Corporation based on the level of pretax income generated by the subsidiary as adjusted for specified intercompany transactions. His bonuses were determined by that formula as revised for 2012.

Equity Incentives. The Compensation Committee believes that equity-based compensation can provide an important incentive to executive officers while also aligning their interests with those of shareholders, since the value of the compensation will depend upon stock price performance. The Employee Stock Ownership Plan, initially established in 2005, and the 2006 Equity Incentive Plan, approved by shareholders in May 2006, provide certain equity-based incentive compensation. Both restricted stock awards and option awards were granted to directors and Bank executive officers in January 2007 and were reported as a component of their total compensation for 2007. The Compensation Committee targeted long-term equity incentives at approximately one-third of total annual compensation for executive management. With regard to the chief executive officer, the Compensation Committee targeted long-term equity incentives at more than half of total annual compensation. The allocation between the restricted stock awards and the option awards was generally an equal split. This is especially true for newly employed executives. For those executives that remain with us throughout the vesting period and who are fully vested in our other benefit plans, the allocation between restricted stock awards and option awards was more heavily weighted to the restricted stock awards. Dividends declared on our stock are paid to the holders of both vested and unvested restricted stock awards.

The initial grants of restricted stock awards and option awards under the 2006 Equity Incentive Plan were made to WaterStone Bank executives on January 5, 2007 and all of those awards vested on or before January 5, 2012. A second significant grant of restricted stock and option awards was made to WaterStone Bank executives on January 4, 2012. The Chief Executive Offer and the non-employee Directors were not eligible for awards in connection with the second grant due to regulatory limitations. Total 2011 compensation expense reported in the audited Waterstone Financial, Inc. consolidated financial statements included equity compensation expense of $1,087,380 for the Chief Executive Officer and all non-employee directors. There is no comparable expense reported in 2012. Both the 2007 and the 2012 grant dates were prior to the availability of fourth quarter operating information and were more than a month prior to our fourth quarter earnings release. The grant price and the exercise price of the option awards granted were equal to the closing market price for our shares of common stock on the grant dates. The equity incentive elements of total compensation very clearly tie to the compensation committee’s objectives of executive retention due to the vesting schedules and to enhanced shareholder value due to the tie to our share value. A stock option award was granted to Mr. Egenhoefer on October 20, 2010. The grant price and the exercise price of the option awards granted were equal to the closing market price for our shares of common stock on the grant date.

In the event of a change in control, the unvested equity incentive awards held by each recipient will vest automatically. Vested awards may be immediately cancelled and paid out in cash or stock based upon the highest fair market value per share of the stock during the 60-day period immediately preceding cancellation. A second-step conversion of our mutual holding company to stock form will not be considered a change in control.

The Employee Stock Ownership Plan is a tax-qualified retirement plan that benefits all eligible WaterStone Bank employees proportionately. The Employee Stock Ownership Plan replaced the Bank’s defined benefit pension plan and is not separately considered in the review and evaluation of annual executive compensation. Employee Stock Ownership Plan allocations are made annually as of December 31 to all eligible Bank employees. An employee must complete a full year of service and be employed by us on December 31 in order to receive an annual allocation each year. In the event of plan termination, all allocated benefits become fully vested immediately. Dividends paid with respect to shares of our stock allocated to participant accounts shall be used to repay any Employee Stock Ownership Plan loan or credited proportionately to participant accounts.

Our chief executive officer had an active role in working with the compensation committee to develop overall, long-term compensation programs. All final decisions were made exclusively by the compensation committee.

Chief Executive Officer Compensation. Base salary and bonus paid to Douglas S. Gordon for the year ended December 31, 2012 increased by 169.0% as a result of the significant improvement in the Company’s operating performance combined with the lack of stock incentive compensation available. That increase is exclusive of equity incentive compensation. Total 2011 compensation expense reported in the Waterstone Financial, Inc. consolidated financial statements included Chief Executive Officer stock incentive expense of $604,100. There was no comparable expense reported in 2012. Mr. Gordon’s long-term commitment to us is supported by the equity incentive awards issued in 2007 that vested over the five years ended January 5, 2012.

Regulatory limitations on restricted stock and stock option grants made to the Chief Executive Officer mean that there are minimal equity incentive awards remaining in the 2006 Equity Incentive Plan that can be granted to Mr. Gordon.

Say-on-Pay. In accordance with the rules of the Securities and Exchange Commission, at our 2012 Annual Meeting of Shareholders, we held an advisory, non-binding vote to approve the compensation of our Named Executive Officers as described in the proxy statement (commonly referred to as a "Say-on-Pay Vote"), which vote received an overwhelming majority of the votes cast in favor of the proposal. At our 2011 annual meeting of stockholders, our shareholders recommended that we hold a "Say-on-Pay Vote on an annual basis. Our Compensation Committee considered the recommendation of the shareholders at our 2012 Annual Meeting of Stockholders in reviewing executive compensation. In addition, we have determined to include the Say-on-Pay Vote in our proxy materials for each annual meeting of shareholders until the next vote on the frequency of the Say-on-Pay Vote, which will occur no later than our 2017 annual meeting of shareholders.

Compensation Committee Report

The compensation committee has reviewed and discussed the section of this prospectus entitled “Compensation Discussion and Analysis” with management. Based on this review and discussion, the compensation committee recommended to the board of directors that the “Compensation Discussion and Analysis” be included in this prospectus.

This report has been provided by the compensation committee:
Patrick S. Lawton, Chairman
Thomas E. Dalum
Michael L. Hansen
Stephen J. Schmidt

PROPOSAL 2 – ADVISORY VOTE ON EXECUTIVE COMPENSATION

The compensation of our Principal Executive Officer, Principal Financial Officer and the three other most highly compensated executive officers of the Company (“Named Executive Officers”) is described above in general and is shown in detail in the Executive Compensation and Compensation Discussion and Analysis sections. Shareholders are urged to read the Executive Compensation and Compensation Discussion and Analysis sections of this Proxy Statement, which discusses our compensation policies and procedures with respect to our Named Executive Officers.

In accordance with Section 14A of the Exchange Act, shareholders will be asked at the Annual Meeting to provide their support with respect to the compensation of our Named Executive Officers by voting on the following advisory, non-binding resolution:

RESOLVED, that the compensation paid to the “named executive officers,” as disclosed in the Company’s Proxy Statement for the 2013 Annual Meeting of Shareholders pursuant to Item 402 Securities and Exchange Commission Regulation S-K, including the Compensation Discussion and Analysis, the 2012 compensation tables and narrative discussion is hereby approved.

This advisory vote, commonly referred to as a “say-on-pay” advisory vote, is non-binding on the board of directors. Although non-binding, the board of directors and the compensation committee value constructive dialogue on executive compensation and other important governance topics with our shareholders and encourage all shareholders to vote their shares on this matter. The board of directors and the compensation committee will review the voting results and take them into consideration when making future decisions regarding our executive compensation.

Unless otherwise instructed, validly executed proxies will be voted “FOR” this resolution.

The board of directors unanimously recommends that you vote "FOR" the resolution set forth in Proposal 2.

EXECUTIVE COMPENSATION

Summary Compensation Table. The following table shows the compensation of Douglas S. Gordon, our principal executive officer, Richard C. Larson, our principal financial officer and three other executive officers who received total compensation of more than $100,000 during the past fiscal year. The "Non-equity Incentive Plan Compensation" and "Change in Pension Value and Nonqualified Deferred Compensation Earnings" columns have been omitted because no listed individual earned any compensation during the listed years of a type required to be disclosed in these columns.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)(1)	Bonus ($)	Stock Awards ($)(2)	Option Awards ($)(2)	All Other Compensation ($)(3)	Total ($)
Douglas S. Gordon	2012	780,000	350,000	—	—	16,492	1,146,492
Chief Executive Officer of	2011	420,000	—	—	—	16,263	436,263
Waterstone Financial and	2010	420,000	—	—	—	7,320	427,320
WaterStone Bank							
Richard C. Larson	2012	240,000	30,000	47,250	37,500	23,796	378,546
Chief Financial Officer of	2011	236,000	—	—	—	21,458	257,458
Waterstone Financial and	2010	233,400	—	—	—	19,762	253,162
WaterStone Bank							
William F. Bruss	2012	207,200	30,000	47,250	43,750	26,288	354,488
General Counsel and Senior	2011	204,200	—	—	—	21,448	225,648
Vice President of Waterstone	2010	196,700	—	—	—	18,363	215,063
Financial and WaterStone							
Bank							
Eric J. Egenhoefer	2012	247,115	879,371	—	—	6,600	1,133,086
President of Waterstone	2011	200,000	80,000	—	—	5,600	285,600
Mortgage Corporation	2010	173,462	120,000	—	109,000	—	402,462
Rebecca M. Arndt	2012	152,000	20,000	28,350	25,000	16,893	242,243
Bank Vice President, Retail	2011	148,000	—	—	—	12,064	160,064
Operations	2010	145,000	—	—	—	18,074	163,074

(1) Salary includes amounts contributed by participants in the WaterStone Bank 401(k) Plan. Mr. Gordon's salary includes 401(k) contributions of $22,500 in 2012, $19,314 in 2011 and $22,000 in 2010. Mr. Larson's salary includes 401(k) contributions of $5,514 in 2012 and $4,085 in 2011. Mr. Bruss' salary includes 401(k) contributions of $9,875 in 2012, $5,483 in 2011 and $6,506 in 2010. Ms. Arndt's salary includes 401(k) contributions of $15,177 in 2012, $14,093 in 2011 and $14,509 in 2010. Mr. Egenhoefer contributed $16,500 to the Waterstone Mortgage Corp 401(k) Plan in 2010.

(2) Reflects the aggregate grant-date fair value of the stock and option awards granted during the years shown as calculated in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718. The assumptions used in the valuation of these awards are included in Note 10 to Waterstone Financial's audited financial statements for the years ended December 31, 2012, 2011 and 2010 included in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission.

(3) All other 2012 compensation includes Employee Stock Ownership Plan shares valued at $4.02 per share allocated on December 31, 2012 and total $10,263 for Messrs. Gordon and Larson, $9,941 for Mr. Bruss and $7,204 for Ms. Arndt. Mr. Egenhoefer is not eligible to participate in the Employee Stock Ownership Plan. All other 2011 compensation includes Employee Stock Ownership Plan shares valued at $2.65 per share allocated on December 31, 2011 and total $7,517 for Mr. Gordon, $7,285 for Mr. Larson, $6,289 for Mr. Bruss and $4,537 for Ms. Arndt. All other 2010 compensation includes Employee Stock Ownership Plan shares valued at $3.48 per share allocated on December 31, 2010 and total $8,467 for Mr. Gordon, $8,227 for Mr. Larson, $6,922 for Mr. Bruss and $5,105 for Ms. Arndt. All other compensation also includes club membership dues. Mr. Gordon's membership dues were expense of $1,498 for 2012, expense of $1,699 for 2011 and a refund of $7,770 for 2010; Mr. Larson's membership dues were $5,280 for 2012, $5,615 for 2011 and $4,960 for 2010; Mr. Bruss' membership dues were $6,884 for 2012, $6,621 for 2011 and $6,411 for 2010; Ms. Arndt's dues were $925 for 2012, and $984 for 2011 and 2010. All other compensation includes personal use of Company-owned vehicles. The value of such use amounted to $4,731 in 2012, $7,051 in 2011 and $6,623 in 2010 for Mr. Gordon; $8,253 in 2012, $8,558 in 2011 and $6,575 in 2010 for Mr. Larson; $9,462 in 2012, $8,538 in 2011 and $5,030 in 2010 for Mr. Bruss; $8,765 in 2012, $6,543 in 2011 and $11,985 in 2010 for Ms. Arndt. Mr. Egenhoefer was paid a car allowance of $6,600 in 2012 and $5,600 in 2011.

Plan-based awards. The following table sets forth for the year ended December 31, 2012 certain information as to grants of plan-based equity awards. The awards set forth in the following table vest ratably over a five-year period, and stock options expire if not exercised prior to the end of the tenth year.

GRANTS OF PLAN-BASED AWARDS FOR THEYEAR ENDED DECEMBER 31, 2012

Name	Grant Date	All other stock awards: number of shares or units (#)	All other option awards: number of securities underlying options (#)	Exercise or base price of option awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)
Richard C. Larson	1/4/12	25,000	—	—	47,250
	1/4/12	—	30,000	1.89	37,500
William E. Bruss	1/4/12	25,000	—	—	47,250
	1/4/12	—	35,000	1.89	43,750
Rebecca M. Arndt	1/4/12	15,000	—	—	28,350
	1/4/12	—	20,000	1.89	25,000

Outstanding Equity Awards at Year End. The following table sets forth information with respect to outstanding equity awards as of December 31, 2012. All grants were made under our 2006 Equity Incentive Plan.

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2012

	Option Awards				Stock Awards	
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)(1)	Market Value of Shares or Units of Stock That Have Not Vested ($)(2)
Douglas S. Gordon	250,000	—	17.67	1/5/2017	—	—
Richard C. Larson	50,000	—	17.67	1/5/2017	25,000	195,000
	—	30,000 (3)	1.89	1/4/2022		
William F. Bruss	50,000	—	17.67	1/5/2017	25,000	195,000
	—	35,000 (3)	1.89	1/4/2022		
Rebecca M. Arndt	25,000	—	17.67	1/5/2017	15,000	117,000
	—	20,000 (3)	1.89	1/4/2022		
Eric J. Egenhoefer	20,000	30,000 (3)	3.80	10/20/2020	—	—

(1) Consists of restricted shares awarded on January 4, 2012 under the 2006 Equity Incentive Plan. The restricted shares vest in five annual increments of 20% each beginning on the first anniversary of the initial award.
(2) Based on the $7.80 per share closing price of our common stock on December 31, 2012, the last trading day of the year.
(3) Options vest in five annual increments of 20% each beginning on the first anniversary of the grant date.

Option Exercises and Stock Vested. The following table sets forth information with respect to option exercises and stock that vested during the year ended December 31, 2012

OPTION EXERCISES AND STOCK VESTED
DURING THE YEAR ENDED DECEMBER 31, 2012

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting(#)	Value Realized on Vesting ($)(1)
Douglas S. Gordon	—	—	20,000	37,800
Richard C. Larson	—	—	3,300	6,237
William F. Bruss	—	—	2,700	5,103
Rebecca M. Arndt	—	—	2,000	3,780
Eric J. Egenhoefer	—	—	—	—

(1) Based on the $1.89 per share closing price of our common stock on January 4, 2012.

Other Benefit Plans

Employee Stock Ownership Plan and Trust. The Employee Stock Ownership Plan became effective on October 4, 2005. Employees who are at least 21 years old and who have completed at least one year of service are eligible to participate. The Employee Stock Ownership Plan trust borrowed funds from Waterstone Financial for the purchase of 761,515 shares in the open market, which represented 7.5% of the total Waterstone Financial shares sold in the initial public offering and those contributed to the charitable foundation.

The common stock purchased by the Employee Stock Ownership Plan serves as collateral for the loan. The loan is being repaid principally from WaterStone Bank discretionary contributions to the Employee Stock Ownership Plan over a period of up to 10 years. The loan documents provide that the loan may be repaid over a shorter period, without penalty for prepayments. The interest rate for the loan is fixed at 5.0% per annum. Shares purchased by the Employee Stock Ownership Plan are held in a suspense account for allocation among participants as the loan is repaid.

Contributions to the Employee Stock Ownership Plan and shares released from the suspense account in an amount proportional to the repayment of the Employee Stock Ownership Plan loan are allocated among Employee Stock Ownership Plan participants on the basis of their compensation in the year of allocation. Benefits under the plan vest in accordance with a graded vesting schedule providing full vesting after the completion of six years of credited service. A participant's interest in his account under the plan fully vests in the event of termination of service due to a participant's normal retirement, death, or disability. Vested benefits are payable in the form of common stock and/or cash and benefits are generally distributable upon a participant's separation from service.

WaterStone Bank contributions to the Employee Stock Ownership Plan are discretionary, subject to the loan terms and tax law limits. In any plan year, WaterStone Bank may make additional discretionary contributions (beyond those necessary to satisfy the loan obligation) to the Employee Stock Ownership Plan for the benefit of plan participants in either cash or shares of common stock, which may be acquired through the purchase of outstanding shares in the market or from individual shareholders or which constitute authorized but unissued shares or shares held in treasury by Waterstone Financial. The timing, amount and manner of discretionary contributions will be affected by several factors, including applicable regulatory policies, the requirements of applicable laws and regulations and market conditions. WaterStone Bank’s contributions to the Employee Stock Ownership Plan are not fixed; therefore, benefits payable under the Employee Stock Ownership Plan cannot be estimated. We are required to record compensation expense each year in an amount equal to the fair market value of the shares committed to be released. During the year ended December 31, 2012, 76,151 shares were allocated to participants in the Employee Stock Ownership Plan, which resulted in compensation expense of $306,000 for the year ended December 31, 2012.

Plan participants are entitled to direct the plan trustee on how to vote common stock credited to their accounts. The trustee votes all allocated shares held in the Employee Stock Ownership Plan as instructed by the plan participants and unallocated shares and allocated shares for which no instructions are received will be voted by the trustee, subject to the fiduciary responsibilities of the trustee.

The Employee Stock Ownership Plan must meet certain requirements of the Internal Revenue Code and the Employee Retirement Income Security Act. WaterStone Bank received a favorable determination letter from the Internal Revenue Service regarding the tax-qualified status of the Employee Stock Ownership Plan in 2012.

401(k) Plan. The WaterStone Bank 401(k) Plan and the Waterstone Mortgage Corporation 401(k) Plan are tax qualified plans under Section 401(a) of the Internal Revenue Code with a cash or deferred arrangement under Section 401(k) of the Internal Revenue Code. Bank employees over the age of 18 and Waterstone Mortgage employees over the age of 21 become eligible to make salary reduction contributions to the 401(k) Plan and to receive any matching or discretionary contributions made to the 401(k) Plan by WaterStone Bank or Waterstone Mortgage Corporation on the first of the month following their date of employment.

Participants under age 50 could elect to annually contribute a maximum of $17,000 in calendar year 2012 while participants age 50 and greater could elect a maximum annual contribution of $22,500. Maximum annual employee contributions are further restricted to 90% of eligible compensation. WaterStone Bank and/or Waterstone Mortgage Corporation may make discretionary profit sharing contributions to their respective 401(k) Plans but have never done so. Waterstone Mortgage added a company match component to its plan during 2012 and as a result, contributed $70,000 to the Plan for the year ended December 31, 2012. Plan participants direct the investment of their accounts in several types of investment funds. Participants are always 100% vested in their elective deferrals and related earnings. Participants become vested in any discretionary profit sharing contributions and related earnings in 20% increments, beginning with the completion of two years of service and ending with the completion of six years of service. Participants are permitted to receive a distribution from the 401(k) Plan only in the form of a lump sum payment.

Director Compensation

Set forth below is summary compensation for each of our non-employee directors for the year ended December 31, 2012.

DIRECTOR COMPENSATION TABLE FOR THE YEAR ENDED DECEMBER 31, 2012

Name	Fees earned or paid in cash ($)(1)	Total ($)
Patrick S. Lawton Chairman of the Board; Compensation Committee Chairman	108,000	108,000
Michael L. Hansen Audit Committee Chairman	88,000	88,000
Stephen J. Schmidt Nominating Committee Chairman	80,500	80,500
Thomas E. Dalum Director	80,500	80,500

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(1) Includes annual retainer, committee and chairmanship fees.
(2) As of December 31, 2012, each of Messrs. Lawton, Hansen, Schmidt and Dalum had 50,000 vested but unexercised stock options, respectively, and no unvested stock options, respectively.

In 2012, we paid each non-employee director an annual retainer of $48,000. In addition, annual fees paid to the Chairman of the Board totaled $20,000 while annual fees paid to the Chairman of the Audit Committee totaled $10,000 and the Chairman of the Compensation Committee received $5,000. Each regular non-chairperson member of each of the two committees previously mentioned received an annual fee of $5,000. Director compensation for 2012 also included a $30,000 bonus paid to the Chairman of the Board, a $27,500 bonus paid to the Chairman of the Audit Committee and a $25,000 bonus paid to the other non-employee directors. Total non-employee director cash compensation increased by $229,000 or 179% over the prior year. Total non-employee director compensation expense as reported in the audited financial statements declined by $254,000, or 42% due to the vesting of all remaining equity incentives originally granted in 2007. Total 2011 director compensation expense reported in the Waterstone Financial, Inc. consolidated financial statements included stock incentive expense of $483,280. There was no comparable expense reported in 2012 since all equity incentive awards issued in 2007 vested over the five years ended January 5, 2012. Regulatory limitations on restricted stock and stock option grants made to directors mean that there are minimal equity incentive awards remaining in the 2006 Equity Incentive Plan that can be granted to non-employee directors. The Compensation Committee commissioned a third-party compensation analysis in 2011 to be used as the basis of for determining both WaterStone Bank's and Waterstone Financial's executive and director compensation for calendar 2012.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Under the federal securities laws, Waterstone Financial directors, its executive officers and any person holding more than 10% of the common stock are required to report their initial ownership of the common stock and any change in that ownership to the SEC. Specific due dates for these reports have been established and we are required to disclose in this Proxy Statement any failure to file such reports by these dates during the last year. We believe that all of these filing requirements were satisfied on a timely basis for the year ended December 31, 2012.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

None of the members of the Compensation Committee was an officer or employee of Waterstone Financial, WaterStone Bank or any subsidiary, nor did any of them have any other reportable interlock.

CERTAIN TRANSACTIONS WITH WATERSTONE FINANCIAL

WaterStone Bank has had, and expects to continue to have, regular business dealings with its officers and directors, as well as their associates and the firms which they serve. Our historical policy has been that transactions with our directors and executive officers be on terms that are no more beneficial to the director or executive officer than we would provide to unaffiliated third parties. Under our policies and procedures, all of our transactions with officers and directors require review, approval or ratification by the board of directors. Directors and executive officers, and their associates, regularly deposit funds with WaterStone Bank. The deposits are made on the same terms and conditions which are offered to other depositors.

In the ordinary course of business, WaterStone Bank makes loans available to its directors, officers and employees. After six months of continuous employment, full-time employees of WaterStone Bank were entitled to receive a mortgage loan at a reduced interest rate, consistent with applicable laws and regulations. In December 2005, the Board discontinued the employee loan program for employee loans originated after March 31, 2006. Employee loans at reduced interest rates originated on or before March 31, 2006 continue on their same terms.

The chart below lists the named executive officers who participated in the employee mortgage loan program during the year ended December 31, 2012 and certain information with respect to their loans. No directors or other executive officers of Waterstone Financial participated in the employee mortgage loan program during the year ended December 31, 2012.

Name	Largest Aggregate Balance 01/01/12 to 12/31/12	Interest Rate	Non-employee Interest Rate	Principal Balance 12/31/12	Principal Paid 01/01/12 to 12/31/12	Interest Paid 01/01/12 to 12/31/12
Richard C. Larson	$ 283,171	2.06%	5.75%	$ 272,457	$ 10,714	$ 5,779
William F. Bruss	$ 281,517	2.06%	5.50%	$ 271,866	$ 9,651	$ 5,754

At the time of termination of employment with WaterStone Bank, the interest rate will be adjusted to the non-employee interest rate as set forth in the mortgage note.

Management believes that these loans neither involve more than the normal risk of collection nor present other unfavorable features. Federal regulations permit executive officers and directors to participate in loan programs that are available to other employees, as long as the director or executive officer is not given preferential treatment compared to other participating employees. Loans made to directors or executive officers, including any modification of such loans, must be approved by a majority of disinterested members of the board of directors. The interest rate on loans to directors and officers is the same as that offered to other employees.

Other than described above, since January 1, 2012, the beginning of our last fiscal year, we and our subsidiaries have not had any transaction or series of transactions, or business relationships, nor are any such transactions or relationships proposed, in which the amount involved exceeds $120,000 and in which our directors, executive officers or 5% or more shareholders have a direct or indirect material interest.

REPORT OF THE AUDIT COMMITTEE

The audit committee of the Waterstone Financial board of directors was created in accordance with Section 3(a)(58)(a) of the Exchange Act. The audit committee's functions include meeting with our independent registered public accounting firm and making recommendations to the board regarding the independent registered public accounting firm; assessing the adequacy of internal controls, accounting methods and procedures; review of public disclosures required for compliance with securities laws; and consideration and review of various other matters relating to the our financial accounting and reporting. No member of the audit committee is employed by or has any other material relationship with us other than as a customer or shareholder. The members are "independent" as defined in Rule 5605(a)(2) of the NASDAQ listing standards. The board of directors has adopted a written charter for the audit committee which can be found on our website.

In connection with its function to oversee and monitor our financial reporting process, the audit committee has done the following:

- reviewed and discussed the audited financial statements for the year ended December 31, 2012 with management;
- discussed with KPMG LLP, our independent registered public accounting firm, those matters which are required to be discussed by Statements on Auditing Standards, AU §380; and
- received the written disclosures and the letter from KPMG LLP required by the Public Company Accounting Oversight Board and has discussed with KPMG LLP its independence.

This report has been provided by the audit committee:
Michael L. Hansen, Chairman
Thomas E. Dalum
Patrick S. Lawton
Stephen J. Schmidt

Based on the foregoing, the audit committee recommended to the board that those audited financial statements be included in our Annual Report on Form 10-K for the year ended December 31, 2012. In addition, the audit committee also considered the fees paid to KPMG LLP for services provided by KPMG during year ended December 31, 2012.

PROPOSAL 3 – RATIFICATION OF THE APPOINTMENT OF OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The firm of KPMG LLP has audited the books and records of Waterstone Financial as of and for the year ended December 31, 2012; and has served as the Bank's principal independent accountant since March 12, 2004. Representatives of KPMG LLP are expected to be present at the annual meeting to respond to appropriate questions and to make a statement if they so desire.

The Audit Committee of the Board of Directors has selected KPMG LLP as our independent registered public accountants for the fiscal year ending December 31, 2013. We are submitting the selection of independent registered public accountants for shareholder ratification at the annual meeting.

If our shareholders do not ratify the selection, the Audit Committee will reconsider whether to retain KPMG LLP, but may still retain them. Even if the selection is ratified, the Audit Committee, in its discretion, may change the appointment at any time during the year if it determines that such a change would be in the best interests of the Company and its shareholders.

The following table presents the aggregate fees for professional services by KPMG LLP for the years ended December 31, 2012 and 2011.

		Year Ended December 31, 2012		Year Ended December 31, 2011
Audit Fees[1]………………	$	220,000	$	220,000
Other[2] ……………………		-		-
Total	$	220,000	$	220,000

(1) Audit fees consist of professional services rendered by KPMG LLP for the audit of our financial statements and review of our Forms 10-Q.

(2) None.

Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services of the Independent Registered Public Accounting Firm

The Audit Committee's policy is to pre-approve all audit and non-audit services provided by the independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to particular service or category of services and is generally subject to a specific budget. The Audit Committee has delegated pre-approval authority to its Chairman when expedition of services is necessary. The independent registered public accounting firm and management are required to periodically report to the full Audit Committee regarding the extent of services provided by the independent registered public accounting firm in accordance with this pre-approval, and the fees for the services performed to date.

SHAREHOLDER PROPOSALS AND NOTICES

Shareholder proposals must be received by the Secretary of Waterstone Financial, William F. Bruss, no later than December 2, 2013 in order to be considered for inclusion in next year's annual meeting proxy materials pursuant to SEC Rule 14a-8.

Under SEC rules relating to the discretionary voting of proxies at shareholder meetings, if a proponent of a matter for shareholder consideration (other than a shareholder proposal) fails to notify Waterstone Financial at least 45 days prior to the month and day of mailing the prior year's Proxy Statement, then management proxies are allowed to use their discretionary voting authority if a proposal is raised at the annual meeting, without any discussion of the matter in the Proxy Statement. Therefore, any such matters must be received by February 14, 2014 in the case of the 2014 annual meeting of shareholders. Waterstone Financial is not aware of any such proposals for the 2013 annual meeting.

Our bylaws provide an advance notice procedure for certain business, or nominations to the Board of Directors, to be brought before an annual meeting. For business to be properly brought before an annual meeting by a shareholder, the shareholder must have given timely notice thereof in writing to our Secretary. To be timely a shareholder's notice must be delivered to or mailed and received at our principal executive offices no later than 30 days before the date of the meeting. A shareholder's notice to the Secretary shall set forth as to each matter the shareholder proposes to bring before the annual meeting (a) a brief description of the business desired to be brought before the annual meeting, (b) the name and address, as they appear on our books, of the shareholder proposing such business, (c) the class and number of shares of Waterstone Financial, Inc. which are beneficially owned by the shareholder, and (d) any material interest of the shareholder in such business. The chairman of an annual meeting may, if the facts warrant, determine and declare to the meeting that certain business was not properly brought before the meeting in accordance with the provisions of our Bylaws, and if he should so determine, he shall so declare to the meeting and any such business not properly brought before the meeting shall not be transacted. This provision is not a limitation on any other applicable laws and regulations.

By Order of the Board of Directors

William F. Bruss
Senior Vice President and Secretary

Wauwatosa, Wisconsin
April 1, 2013

We will provide a copy of the Waterstone Financial Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2012 (without exhibits) without charge to any record or beneficial owner of our common stock on the written request of that person directed to: Richard C. Larson, Chief Financial Officer, Waterstone Financial, Inc., 11200 W. Plank Ct., Wauwatosa, WI 53226. The 10-K provides a list of exhibits, which will be provided for a reasonable fee to reflect duplication and mailing costs; exhibits are also available through the SECs website at www.sec.gov.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

F O R M 1 0 - K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

Commission file number: **000-51507**

WATERSTONE FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Federal (State or other jurisdiction of incorporation or organization)	**20-3598485** (I.R.S. Employer Identification No.)
11200 W Plank Ct, Wauwatosa, Wisconsin (Address of principal executive offices)	**53226** (Zip Code)

(414) 761-1000
Registrant's telephone number, including area code:

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $0.01 Par Value (Title of class)	The NASDAQ Stock Market, LLC (Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark whether the registrant is a well-known seasoned issuer (as defined in Rule 405 of the 1933 Act).

Yes ☐ No ☑

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the 1934 Act.

Yes ☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☑ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)

Yes ☑ No ☐

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 under the Exchange Act).

Yes ☐ No ☑

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant, computed by reference to the last sale price on June 30, 2012, as reported by the NASDAQ Capital Market® was approximately $119.1 million.

As of February 28, 2013, 31,348,556 shares of the Registrant's Common Stock were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Part of Form 10-K Into Which Portions of Document are Incorporated
Proxy Statement for Annual Meeting of Shareholders on May 21, 2013	Part III

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WATERSTONE FINANCIAL, INC.

**FORM 10-K ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION
FOR THE YEAR ENDED DECEMBER 31, 2012**

TABLE OF CONTENTS

Part 1

Waterstone Financial, Inc. and its subsidiaries, including WaterStone Bank, SSB, are referred to herein as the "Company," "Waterstone Financial," or "we."

Item 1. Business

Introduction

Waterstone Financial, Inc. is the mid-tier stock holding company subsidiary of Lamplighter Financial, MHC, formed as part of the reorganization of WaterStone Bank into mutual holding company form. WaterStone Bank was converted from a mutual to a stock savings bank as part of our reorganization. At December 31, 2012, 74% of Waterstone Financial, Inc. outstanding shares were held by Lamplighter Financial, MHC and 26% were held by public shareholders. In this report, we refer to WaterStone Bank, our wholly owned subsidiary, both before and after the reorganization, as "WaterStone Bank" or the "Bank."

The Company and its mutual holding company parent, Lamplighter Financial, MHC (the "MHC"), are federally chartered mutual holding companies. WaterStone Bank is a Wisconsin chartered savings bank.

The Company maintains a website at www.wsbonline.com. We make available through that website, free of charge, copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports and proxy materials as soon as is reasonably practical after the Company electronically files those materials with, or furnishes them to, the Securities and Exchange Commission. You may access those reports by following the links under "Investor Relations" at the Company's website. Information on this website is not and should not be considered a part of this document.

Waterstone Financial, Inc.'s executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226, and its telephone number at this address is (414) 761-1000.

Cautionary Factors

This Form 10-K contains or incorporates by reference various forward-looking statements concerning the Company's prospects that are based on the current expectations and beliefs of management. Forward-looking statements may also be made by the Company from time to time in other reports and documents as well as in oral presentations. When used in written documents or oral statements, the words "anticipate," "believe," "estimate," "expect," "objective" and similar expressions and verbs in the future tense, are intended to identify forward-looking statements. The statements contained herein and such future statements involve or may involve certain assumptions, risks and uncertainties, many of which are beyond the Company's control, that could cause the Company's actual results and performance to differ materially from what is expected. In addition to the assumptions and other factors referenced specifically in connection with such statements, the following factors could impact the business and financial prospects of the Company:

- our ability to maintain regulatory capital levels as imposed by federal and state regulators;
- adverse changes in real estate markets;
- adverse changes in the securities markets;
- general economic conditions, either nationally or in our market area, that are worse than expected;
- inflation and changes in interest rates that reduce our margins or reduce the fair value of financial instruments;
- changes in interest rates that reduce loan origination volumes and, ultimately, income from our mortgage banking operations;
- modification/cessation of governmental programs offered to current and prospective homeowners that reduce loan origination volumes and, ultimately, income from our mortgage banking operations;
- changes in the level of government support for housing finance;
- legislative or regulatory changes that adversely affect our business;
- our ability to enter new markets successfully and to take advantage of growth opportunities;
- significantly increased competition among depository and other financial institutions;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies and the Financial Accounting Standards Board; and
- changes in consumer spending, borrowing and savings habits.

See also the factors regarding future operations discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" below.

BUSINESS OF WATERSTONE BANK

General

WaterStone Bank is a community bank that has served the banking needs of its customers since 1921. WaterStone Bank conducts business from its eight banking offices and nine automated teller machines, including stand-alone automated-teller machines, located in Milwaukee, Washington and Waukesha Counties, Wisconsin.

WaterStone Bank's principal business consists of accepting deposits, primarily through its retail banking offices, and investing those funds in loans and securities. WaterStone Bank offers a variety of deposit accounts with a range of interest rates and terms. To a lesser extent, WaterStone Bank uses borrowed funds and brokered deposits as additional sources of funds. WaterStone Bank's principal lending activity is originating one- to four-family and over four-family residential real estate loans for retention in its portfolio. WaterStone Bank also offers, to a lesser extent, home equity loans and lines of credit, construction and land loans, commercial real estate and commercial business loans, and consumer loans. WaterStone Bank's investment securities portfolio is comprised principally of mortgage-backed securities, government-sponsored enterprise bonds and municipal obligations. WaterStone Bank is subject to comprehensive regulation and examination by the Wisconsin Department of Financial Institutions and the Federal Deposit Insurance Corporation.

Waterstone Mortgage Corporation is a wholly-owned subsidiary of WaterStone Bank. Waterstone Mortgage Corporation originates residential real estate loans for sale into the secondary market. During the year ended December 31, 2012, Waterstone Mortgage Corporation originated $1.7 billion of loans, and had net income of $11.5 million. As of December 31, 2012, Waterstone Mortgage Corporation had 16 offices in Wisconsin, 14 offices in Minnesota, 11 offices in Pennsylvania, 10 offices in Florida, four offices in each of Arizona and Indiana, three offices in Ohio, two offices in each of Idaho and Iowa, and one office in each of Illinois and Maryland.

Competition

We face competition within our market area both in making real estate loans and attracting deposits. The Milwaukee-Waukesha-West Allis metropolitan statistical area has a high concentration of financial institutions, including large commercial banks, community banks and credit unions. The Federal Deposit Insurance Corporation has determined that our market area is a "high-rate" area with regard to deposit pricing as compared to the rest of the United States. As of June 30, 2012, based on the Federal Deposit Insurance Corporation's annual Summary of Deposits Report, we had the sixth largest market share in our metropolitan statistical area representing 1.7% of all deposits.

Our competition for loans and deposits comes principally from commercial banks, savings institutions, mortgage banking firms and credit unions. We face additional competition for deposits from money market funds, brokerage firms, and mutual funds. Some of our competitors offer products and services that we do not offer, such as trust services, private banking and brokerage and insurance services.

Our primary focus is to build and develop profitable consumer and commercial customer relationships while maintaining our role as a community bank.

Market Area

Our market area is broadly defined as the Milwaukee, Wisconsin metropolitan market, which is geographically located in the southeast corner of the state. Our primary market area is Milwaukee and Waukesha counties and the five surrounding counties of Ozaukee, Washington, Jefferson, Walworth and Racine. We have four branch offices in Milwaukee County, three branch offices in Waukesha County and one branch office in Washington County. At June 30, 2012, 48.2% of deposits in the State of Wisconsin were located in the seven-county metropolitan Milwaukee market.

Our primary market area for deposits includes the communities in which we maintain our banking office locations. Our primary lending market area is broader than our primary deposit market area and includes all of the primary market area noted above but extends further west to the Madison, Wisconsin market and further north to the Appleton and Green Bay, Wisconsin markets. In addition to our banking offices, as of December 31, 2012, our mortgage banking operation has 16 offices in Wisconsin, 14 offices in Minnesota, 11 offices in Pennsylvania, 10 offices in Florida, four offices in each of Arizona and Indiana, three offices in Ohio, two offices in each of Idaho and Iowa, and one office in each of Illinois and Maryland.

Lending Activities

The scope of the discussion included under "Lending Activities" is limited to lending operations related to loans originated for investment. A discussion of the lending activities related to loans originated for sale is included under "Mortgage Banking Activities."

Historically, our principal lending activity has been originating mortgage loans for the purchase or refinancing of residential real estate. Generally, we retain the loans that we originate which we refer to as loans originated for investment. One- to four-family residential mortgage loans represented $460.8 million, or 40.7%, of our total loan portfolio at December 31, 2012.

Over four-family residential mortgage loans represented $514.4 million, or 45.4%, of our total loan portfolio at December 31, 2012. We also offer construction and land loans, commercial real estate loans, home equity lines of credit and commercial loans. At December 31, 2012, commercial real estate loans, construction and land loans, home equity loans and commercial business loans totaled $65.5 million, $33.8 million, $36.5 million and $22.5 million, respectively.

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio in dollar amounts and as a percentage of the total portfolio at the dates indicated.

	At December 31,									
	2012		2011		2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Mortgage loans:										
Residential real estate:										
One- to four-family	$ 460,821	40.65%	$ 496,736	40.83%	$ 582,026	44.56%	$ 679,657	47.86%	$ 788,152	50.54%
Over four-family	514,363	45.37%	552,240	45.39%	542,602	41.53%	536,731	37.80%	512,746	32.87%
Home equity	36,494	3.22%	38,599	3.17%	46,149	3.53%	57,589	4.06%	59,281	3.80%
Construction and land	33,818	2.98%	39,528	3.25%	53,961	4.13%	61,953	4.36%	111,599	7.15%
Commercial real estate	65,495	5.78%	65,434	5.38%	51,733	3.96%	48,948	3.45%	55,193	3.54%
Commercial loans	22,549	1.99%	24,018	1.97%	29,812	2.28%	34,513	2.43%	32,422	2.08%
Consumer	132	0.01%	109	0.01%	154	0.01%	619	0.04%	365	0.02%
Total loans	1,133,672	100.00%	1,216,664	100.00%	1,306,437	100.00%	1,420,010	100.00%	1,559,758	100.00%
Allowance for loan losses	(31,043)		(32,430)		(29,175)		(28,494)		(25,167)	
Loans, net	1,102,629		1,184,234		1,277,262		1,391,516		1,534,591	

Loan Portfolio Maturities and Yields. The following table summarizes the final maturities of our loan portfolio at December 31, 2012. Maturities are based upon the final contractual payment dates and do not reflect the impact of prepayments and scheduled monthly payments that will occur.

Maturity Date	One- to four-family Amount	One- to four-family Weighted Average Rate	Over four-family Amount	Over four-family Weighted Average Rate	Home Equity Amount	Home Equity Weighted Average Rate	Construction and Land Amount	Construction and Land Weighted Average Rate
	(Dollars in Thousands)							
Jan 1, 2013 – Dec 31, 2013	$ 29,228	5.66%	$ 45,816	5.84%	$ 10,857	4.34%	$ 16,102	5.25%
Jan 1, 2014 – Dec 31, 2014	33,138	5.79%	42,475	5.70%	5,776	4.01%	2,519	4.80%
Jan 1, 2015 – Dec 31, 2015	5,244	5.10%	22,679	5.06%	8,397	4.07%	3,898	4.54%
Jan 1, 2016 – Dec 31, 2016	5,644	4.63%	7,482	5.16%	3,383	5.12%	799	2.86%
Jan 1, 2017 – Dec 31, 2017	3,544	4.99%	31,088	4.00%	2,110	5.48%	179	4.51%
Jan 1, 2018 and thereafter	384,023	5.19%	364,823	5.12%	5,971	4.65%	10,321	4.50%
Total	$ 460,821	5.26%	$ 514,363	5.16%	$ 36,494	4.41%	$ 33,818	4.85%

Maturity Date	Commercial Real Estate Amount	Commercial Real Estate Weighted Average Rate	Commercial Business Amount	Commercial Business Weighted Average Rate	Consumer Amount	Consumer Weighted Average Rate	Total Amount	Total Weighted Average Rate
	(Dollars in Thousands)							
Jan 1, 2013 – Dec 31, 2013	$ 5,481	6.17%	$ 12,385	6.17%	$ 94	5.60%	119,963	5.36%
Jan 1, 2014 – Dec 31, 2014	6,556	5.77%	1,514	5.77%	14	6.03%	91,992	5.61%
Jan 1, 2015 – Dec 31, 2015	9,513	5.85%	3,173	5.85%	-	-	52,904	5.02%
Jan 1, 2016 – Dec 31, 2016	10,966	5.74%	1,444	5.74%	-	-	29,718	5.22%
Jan 1, 2017 – Dec 31, 2017	9,268	4.84%	684	4.84%	24	3.00%	46,897	4.33%
Jan 1, 2018 and thereafter	23,711	5.61%	3,349	5.61%	-	-	792,198	5.16%
Total	$ 65,495	5.62%	$ 22,549	4.28%	$ 132	4.25%	$ 1,133,672	5.18%

The following table sets forth the scheduled repayments of fixed and adjustable rate loans at December 31, 2012 that are contractually due after December 31, 2013.

	Due After December 31, 2013		
	Fixed	Adjustable	Total
		(In Thousands)	
Mortgage loans			
Real estate loans:			
One- to four-family	28,504	403,089	431,593
Over four-family	59,235	409,312	468,547
Home equity	5,170	20,467	25,637
Construction and land	2,416	15,300	17,716
Commercial	33,215	26,799	60,014
Commercial	8,415	1,749	10,164
Consumer	38	-	38
Total loans	$136,993	876,716	1,013,709

One- to Four-Family Residential Mortgage Loans. WaterStone Bank's primary lending activity is originating residential mortgage loans secured by properties located in Milwaukee and surrounding counties. One- to four-family residential mortgage loans totaled $460.8 million, or 40.7% of total loans at December 31, 2012. One- to four-family residential mortgage loans originated for investment during the year ended December 31, 2012 totaled $17.1 million, or 17.2% of all loans originated for investment. Our one- to four-family residential mortgage loans have fixed or adjustable rates. Our adjustable-rate mortgage loans generally provide for maximum rate adjustments of 100 basis points per adjustment, with a lifetime maximum adjustment of either 300 or 600 basis points, regardless of the initial rate. Our adjustable-rate mortgage loans typically amortize over terms of up to 30 years. Currently, one- to four-family adjustable-rate loans that we retain in our portfolio are not necessarily indexed; those that are not indexed are adjustable semi-annually at our discretion with the limits noted above. We do not and have never offered residential mortgage loans specifically designed for borrowers with sub-prime credit scores, including Alt-A and negative amortization loans. Further, prior to 2007, we did not offer indexed, adjustable-rate loans other than home equity lines of credit and we have never offered "teaser rate" first mortgage products.

Adjustable rate mortgage loans can decrease the interest rate risk associated with changes in market interest rates by periodically repricing, but involve other risks because, as interest rates increase, the underlying payments by the borrower increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate is also limited by the maximum periodic and lifetime interest rate adjustments permitted by our loan documents and, therefore, the effectiveness of adjustable rate mortgage loans in decreasing the risk associated with changes in interest rates may be limited during periods of rapidly rising interest rates. Moreover, during periods of rapidly declining interest rates the interest income received from the adjustable rate loans can be significantly reduced, thereby adversely affecting interest income.

All residential mortgage loans that we originate include "due-on-sale" clauses, which give us the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise transfers the real property subject to the mortgage and the loan is not repaid. We also require homeowner's insurance and where circumstances warrant, flood insurance, on properties securing real estate loans. The average single family first mortgage loan balance was $190,000 and the largest outstanding balance was $3.9 million on December 31, 2012. The average two- to four-family first mortgage loan balance was $152,000 on December 31, 2012 and the largest outstanding balance on that date was $5.1 million, which is a consolidation loan that is collateralized by 29 properties.

Over Four-family Real Estate Loans. Over four-family loans totaled $514.4 million, or 45.4% of total loans at December 31, 2012. Over four-family loans originated during the year ended December 31, 2012 totaled $51.8 million or 52.2% of all loans originated for investment. These loans are generally secured by properties located in our primary market area. Our over four-family real estate underwriting policies generally provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property provided the loan complies with our current loans-to-one borrower limit. Over four-family real estate loans are offered with interest rates that are fixed for periods of up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 30-year amortization period. In reaching a decision on whether to make an over four-family real estate loan, we consider gross revenues and the net operating income of the property, the borrower's expertise and credit history, business cash flow, and the appraised value of the underlying property. In addition, we will also consider the terms and conditions of the leases and the credit quality of the tenants. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, taxes, depreciation and amortization divided by interest expense and current maturities of long term debt) of at least 1.15 times. Generally, over four-family loans made to corporations, partnerships and other business entities require personal guarantees by the principals and by the owners of 20% or more of the borrower.

An over four-family borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We generally require borrowers with aggregate outstanding balances exceeding $1.0 million to provide updated financial statements and federal tax returns annually. These requirements also apply to all guarantors on these loans. We also require borrowers with rental investment property to provide an annual report of income and expenses for the property, including a tenant list and copies of leases, as applicable. The average outstanding over four-family mortgage loan balance was $716,000 on December 31, 2012 with the largest outstanding balance at $7.8 million. At December 31, 2012, our largest exposure to one borrower or to a related group of borrowers was $20.1 million. The largest loan in the group is a mortgage loan with an outstanding balance at December 31, 2012 of $7.8 million.

Loans secured by over four-family real estate generally involve larger principal amounts and greater risk than owner-occupied, one- to four-family residential mortgage loans. Because payments on loans secured by over four-family properties often depend on the successful operation or management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy.

Home Equity Loans and Lines of Credit. We also offer home equity loans and home equity lines of credit, both of which are secured by owner-occupied and non-owner occupied one- to four-family residences. At December 31, 2012, outstanding home equity loans and equity lines of credit totaled $36.5 million, or 3.2% of total loans outstanding. At December 31, 2012, the unadvanced portion of home equity lines of credit totaled $17.6 million. Home equity loans and lines originated during the year ended December 31, 2012 totaled $3.1 million, or 3.1% of all loans originated for investment. The underwriting standards utilized for home equity loans and home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan, and the value of the collateral securing the loan. Home equity loans are offered with adjustable rates of interest and with terms up to 10 years. The loan-to-value ratio for our home equity loans and our lines of credit is generally limited to 90% when combined with the first security lien, if applicable. Our home equity lines of credit have ten-year terms and adjustable rates of interest, subject to a contractual floor, which are indexed to the prime rate, as reported in *The Wall Street Journal*. Interest rates on home equity lines of credit are generally limited to a maximum rate of 18%. The average outstanding home equity loan balance was $48,000 at December 31, 2012 with the largest outstanding balance at that date of $897,000.

Residential Construction and Land Loans. We originate construction loans to individuals and contractors for the construction and acquisition of single and multi-family residences. At December 31, 2012, construction and land loans totaled $33.8 million, or 3.0%, of total loans. Construction and land loans originated during the year ended December 31, 2012 totaled $2.7 million, or 2.7% of all loans originated for investment. At December 31, 2012, the unadvanced portion of these construction loans totaled $5.5 million.

Our construction mortgage loans generally provide for the payment of interest only during the construction phase, which is typically up to nine months although our policy is to consider construction periods as long as 12 months or more. At the end of the construction phase, the construction loan converts to a longer term mortgage loan. Construction loans can be made with a maximum loan-to-value ratio of 90%, provided that the borrower obtains private mortgage insurance if the loan balance exceeds 80% of the lesser of the appraised value or sales price of the secured property. The average outstanding construction loan balance totaled $852,000 on December 31, 2012 with the largest outstanding balance at $2.9 million. The average outstanding land loan balance was $376,000 on December 31, 2012, and the largest outstanding balance on that date was $5.0 million.

Before making a commitment to fund a residential construction loan, we require an appraisal of the property by an independent licensed appraiser. We also review and inspect each property before disbursement of funds during the term of the construction loan. Loan proceeds are disbursed after inspection based on the status of completion.

Construction financing is generally considered to involve a higher degree of credit risk than longer-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost is inaccurate, we may be required to advance funds beyond the amount originally committed in order to protect the value of the property. Additionally, if the estimate of value is inaccurate, we may be confronted with a project, when completed, that is insufficient to ensure full repayment of the loan.

Commercial Real Estate Loans. Commercial real estate loans totaled $65.5 million at December 31, 2012, or 5.8% of total loans, and are made up of loans secured by office and retail buildings, churches, restaurants, other retail properties and mixed use properties. Commercial real estate loans originated during the year ended December 31, 2012 totaled $14.6 million, or 14.7% of all loans originated for investment. These loans are generally secured by property located in our primary market area. Our commercial real estate underwriting policies provide that such real estate loans may be made in amounts of up to 80% of the appraised value of the property. Commercial real estate loans are offered with interest rates that are fixed up to five years or are variable and either adjust based on a market index or at our discretion. Contractual maturities do not exceed 10 years while principal and interest payments are typically based on a 30-year amortization period. In reaching a decision on whether to make a commercial real estate loan, we consider gross revenues and the net operating income of the property, the borrower's expertise and credit history, business cash flow, and the appraised value of the underlying property. In addition, we will also consider the terms and conditions of the leases and the credit quality of the tenants. We generally require that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before interest, taxes, depreciation and amortization divided by interest expense and current maturities of long term debt) of at least 1.15 times. Environmental surveys are required for commercial real estate loans when environmental risks are identified. Generally, commercial real estate loans made to corporations, partnerships and other business entities require personal guarantees by the principals and by the owners of 20% or more of the borrower.

A commercial real estate borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We generally require borrowers with aggregate outstanding balances exceeding $1.0 million to provide annually updated financial statements and federal tax returns. These requirements also apply to all guarantors on these loans. We also require borrowers to provide an annual report of income and expenses for the property, including a tenant list and copies of leases, as applicable. The average commercial real estate loan in our portfolio at December 31, 2012 was $516,000, and the largest outstanding balance at that date was $3.6 million.

Commercial Loans. Commercial loans totaled $22.5 million at December 31, 2012, or 2.0% of total loans, and are made up of loans secured by accounts receivable, inventory, equipment and real estate. Commercial loans originated during the year ended December 31, 2012 totaled $9.9 million, or 9.9% of all loans originated. These loans are generally made to borrowers that are located in our primary market area. Working capital lines of credit are granted for the purpose of carrying inventory and accounts receivable or purchasing equipment. These lines require that certain working capital ratios must be maintained and are monitored on a monthly or quarterly basis. Working capital lines of credit are short-term loans of 12 months or less with variable interest rates. At December 31, 2012, the unadvanced portion of working capital lines of credit totaled $11.0 million. Outstanding balances fluctuate up to the maximum commitment amount based on fluctuations in the balance of the underlying collateral. Personal property loans secured by equipment are considered commercial business loans and are generally made for terms of up to 84 months and for up to 80% of the value of the underlying collateral. Interest rates on equipment loans may be either fixed or variable. Commercial business loans are generally variable rate loans with initial fixed rate periods of up to five years. These loans generally amortize over 15 to 25 years.

A commercial business borrower's financial information is monitored on an ongoing basis by requiring periodic financial statement updates, usually quarterly, payment history reviews and periodic face-to-face meetings with the borrower. The average outstanding commercial loan at December 31, 2012 was $198,000 and the largest outstanding balance on that date was $4.6 million.

The following table shows loan origination, principal repayment activity, transfers to real estate owned, charge-offs and sales during the years indicated.

	As of or for the Year Ended December 31,		
	2012	2011	2010
	(In Thousands)		
Total gross loans receivable and held for sale at beginning of year	$1,304,947	1,443,824	1,516,800
Real estate loans originated for investment:			
Residential			
One- to four-family	17,088	13,651	11,390
Over four-family	51,816	60,367	69,602
Home equity	3,112	4,328	5,528
Construction and land	2,695	3,487	8,355
Commercial real estate	14,572	25,398	5,813
Total real estate loans originated for investment	89,283	107,231	100,688
Consumer loans originated for investment	35	-	76
Commerical loans originated for investment	9,857	9,366	11,204
Total loans originated for investment	99,175	116,597	111,968
Real estate loans purchased for investment:			
One- to four-family	12,148	-	-
Home equity	3,338	-	-
Total real estate loans purchased for investment	15,486	-	-
Principal repayments	(165,683)	(200,544)	(169,093)
Transfers to real estate owned	(22,282)	(28,259)	(41,781)
Loan principal charged-off, net of recoveries	(9,687)	(18,821)	(25,151)
Net activity in loans held for investment	(82,991)	(131,027)	(124,057)
Loans originated for sale	1,749,426	1,027,346	1,084,362
Loans sold	(1,704,097)	(1,035,196)	(1,033,281)
Net activity in loans held for sale	45,329	(7,850)	51,081
Total gross loans receivable and held for sale at end of year	$1,267,285	1,304,947	1,443,824

Origination and Servicing of Loans. All loans originated for investment are underwritten pursuant to internally developed policies and procedures. While we generally underwrite owner-occupied residential mortgage loans to Freddie Mac and Fannie Mae standards, due to several unique characteristics, our loans originated prior to 2008 do not conform to the secondary market standards. The unique features of these loans include: interest payments in advance of the month in which they are earned, discretionary rate adjustments that are not tied to an independent index and pre-payment penalties.

Exclusive of our mortgage banking operations, we generally retain in our portfolio a significant majority of the loans that we originate. At December 31, 2012, WaterStone Bank was servicing $2.9 million in loan participations we originated and subsequently sold to unrelated third parties. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans.

Loan Approval Procedures and Authority. WaterStone Bank's lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by WaterStone Bank's board of directors. The loan approval process is intended to assess the borrower's ability to repay the loan, the viability of the loan and the adequacy of the value of the property that will secure the loan, if applicable. To assess the borrower's ability to repay, we review the employment and credit history and information on the historical and projected income and expenses of borrowers.

Loan officers are authorized to approve and close any loan that qualifies under WaterStone Bank underwriting guidelines within the following lending limits:

- A secured one- to four-family mortgage loan up to $500,000 for a borrower with total outstanding loans from the Bank of less than $1,000,000 that is independently underwritten can be approved by select loan officers.

- A loan up to $500,000 for a borrower with total outstanding loans from the Bank of less than $500,000 can be approved by select commercial loan officers.

- Any secured mortgage loan ranging from $500,001 to $2,999,999 or any new loan to a borrower with outstanding loans from the Bank exceeding $1,000,000 must be approved by the Officer Loan Committee.

- Any loan for $3,000,000 or more must be approved by the Officer Loan Committee and the board of directors prior to closing. Any new loan to a borrower with outstanding loans from the Bank exceeding $10,000,000 must be approved by the board of directors prior to closing.

Asset Quality

When a loan becomes more than 30 days delinquent, WaterStone Bank sends a letter advising the borrower of the delinquency. The borrower is given 30 days to pay the delinquent payments or to contact WaterStone Bank to make arrangements to bring the loan current over a longer period of time. If the borrower fails to bring the loan current within 90 days from the original due date or to make arrangements to cure the delinquency over a longer period of time, the matter is referred to legal counsel and foreclosure or other collection proceedings are considered. We may consider forbearance in select cases where a temporary loss of income might result, if a reasonable plan is presented by the borrower to cure the delinquency in a reasonable period of time after his or her income resumes.

All loans are reviewed on a regular basis, and such loans are placed on non-accrual status when they become more than 90 or more days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is reversed, and further income is recognized only to the extent received.

Non-Performing Assets. Non-performing assets consist of non-accrual loans and other real estate owned. Loans are generally placed on non-accrual status when contractually past due 90 days or more as to interest or principal payments. Additionally, whenever management becomes aware of facts or circumstances that may adversely impact the collectibility of principal or interest on loans, management may place such loans on non-accrual status immediately, rather than waiting until the loan becomes 90 days past due. At that time, previously accrued and uncollected interest on such loans is reversed and additional income is recorded only to the extent that payments are received and the collection of principal is reasonably assured. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

The table below sets forth the amounts and categories of our non-accrual loans and real estate owned at the dates indicated.

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Non-accrual loans:					
Residential					
One- to four-family	$ 46,467	55,609	56,759	45,988	42,182
Over four-family	23,205	13,680	20,587	16,683	35,787
Home equity	1,578	1,334	712	1,159	2,015
Construction and land	2,215	6,946	3,013	6,269	18,271
Commercial real estate	668	514	1,577	2,773	9,325
Commercial	511	135	1,530	2,441	150
Consumer	24	-	-	-	-
Total non-accrual loans	74,668	78,218	84,178	75,313	107,730
Real estate owned					
One- to four-family	17,353	27,449	28,142	27,016	16,720
Over four-family	9,890	16,231	14,903	8,824	6,057
Construction and land	7,029	8,796	9,926	10,458	1,094
Commercial real estate	1,702	4,194	4,781	4,631	782
Total real estate owned	35,974	56,670	57,752	50,929	24,653
Total non-performing assets	$ 110,642	134,888	141,930	126,242	132,383
Total accruing troubled debt restructurings	$ 16,011	24,589	33,592	42,730	2,409
Total non-accrual loans to total loans, net	6.59%	6.43%	6.44%	5.30%	6.91%
Total non-accrual loans and accruing troubled debt restructurings to total loans receivable	8.00%	8.45%	9.01%	8.31%	7.06%
Total non-accrual loans to total assets	4.50%	4.57%	4.65%	4.03%	5.71%
Total non-performing assets to total assets	6.66%	7.88%	7.85%	6.76%	7.02%

All loans that exceed 90 days with respect to past due principal and interest are recognized as non-accrual. Troubled debt restructurings which are still on nonaccrual either due to being past due greater than 90 days, or which have not yet performed under the modified terms for a reasonable period of time, are included in the table above. In addition, loans which are past due less than 90 days are evaluated to determine the likelihood of collectability given other credit risk factors such as early stage delinquency, the nature of the collateral or the results of a borrower fiscal review. When the collection of all contractual principal and interest is determined to be unlikely, the loan is moved to non-accrual status and an updated appraisal of the underlying collateral is ordered. This process generally takes place between contractual past due dates 60 and 90 days. Upon determining the updated estimated value of the collateral, a loan loss provision is recorded to establish a specific reserve to the extent that the outstanding principal balance exceeds the updated estimated net realizable value of the collateral. When a loan is determined to be uncollectible, typically coinciding with the initiation of foreclosure action, the specific reserve is reviewed for adequacy, adjusted if necessary, and charged-off.

Total non-accrual loans decreased by $3.6 million, or 4.5%, to $74.7 million as of December 31, 2012 compared to $78.2 million as of December 31, 2011. Notwithstanding the decrease in non-accrual loans during the current year, the ratio of non-accrual loans to total loans increased to 6.59% at December 31, 2012 compared to 6.43% at December 31, 2011 due to total loans decreasing by 6.8%, or $83.0 million, during the year ended December 31, 2012. A total of $44.6 million in loans were placed on non-accrual status during the year ended December 31, 2012. Offsetting the addition were $22.3 million in transfers to real estate owned (net of charge-offs), $8.2 million in loans that returned to accrual status, $6.9 million in charge-offs and $6.7 million in principal pay downs.

Our largest non-accrual relationship at December 31, 2012 consisted of five loans with an aggregate principal balance of $11.0 million, all of which are collateralized by over four-family residential real estate. The loans are part of a troubled debt restructuring, and are performing in accordance with their modified terms. We have established a specific valuation allowance of $1.2 million for these loans, or 10.7% of the outstanding principal balance of the loans at December 31, 2012. This relationship includes four of our six largest non-accrual loans as of December 31, 2012. Our two remaining largest non-accrual loans as of December 31, 2012 were also collateralized by over four-family residential real estate located in southeastern Wisconsin. These two loans had a combined principal balance of $6.8 million at December 31, 2012 and combined specific valuation allowances of $534,000. Together, the loan relationship and the other two largest non-accrual loans comprised 23.2% of total non-accrual loans and 74.6% of total non-accrual loans secured by over four-family residential real estate at December 31, 2012.

Of the $74.7 million in total non-accrual loans as of December 31, 2012, $62.4 million in loans have been specifically reviewed to assess whether a specific valuation allowance is necessary. A specific valuation allowance is established for an amount equal to the impairment when the carrying value of the loan exceeds the present value of expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral with an adjustment made for costs to dispose of the asset. Based upon these specific reviews, a total of $5.8 million in partial charge-offs have been recorded with respect to these loans as of December 31, 2012. Partially charged-off loans measured for impairment based upon net realizable collateral value are maintained in a "non-performing" status and are disclosed as impaired loans. In addition, specific reserves totaling $8.9 million have been recorded as of December 31, 2012. The remaining $12.3 million of non-accrual loans were reviewed on an aggregate basis and $3.0 million in general valuation allowance was deemed necessary as of December 31, 2012. The $3.0 million in general valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

There were no accruing loans past due 90 days or more during the years ended December 31, 2012, 2011 or 2010.

Troubled Debt Restructurings.

The following table summarizes troubled debt restructurings by the Company's internal risk rating:

	At December 31,				
	2012	**2011**	**2010**	**2009**	**2008**
	(Dollars in Thousands)				
Troubled debt restructurings					
Substandard	$ 48,449	47,220	15,769	18,003	2,409
Watch	11,172	8,192	20,703	34,082	-
Total troubled debt restructurings	$ 59,621	55,412	36,472	52,085	2,409

Troubled debt restructurings increased $4.2 million, or 7.6%, to $59.6 million at December 31, 2012 from $55.4 million at December 31, 2011. All troubled debt restructurings are considered to be impaired and are risk rated as either substandard or watch and are included in the internal risk rating tables disclosed in Note 3 in the notes to the financial statements. Specific reserves have been established to the extent that the collateral-based impairment analyses indicate that a collateral shortfall exists or to the extent that a discounted cash flow analysis results in an impairment.

Information with respect to the accrual status of our troubled debt restructurings is provided in the following table.

	As of December 31, 2012		
	Accruing	**Non-accruing**	**Total**
		(In Thousands)	
One- to four-family	$ 9,921	$ 21,847	$ 31,768
Over four-family	3,917	20,030	23,947
Home equity	-	986	986
Construction and land	2,173	79	2,252
Commercial real estate	-	668	668
	$ 16,011	$ 43,610	$ 59,621

	As of December 31, 2011		
	Accruing	**Non-accruing**	**Total**
One- to four-family	$ 8,293	$ 26,773	$ 35,066
Over four-family	14,845	2,453	17,298
Home equity	43	1,024	1,067
Construction and land	1,408	79	1,487
Commercial real estate	-	452	452
Commercial	-	42	42
	$ 24,589	$ 30,823	$ 55,412

Loan Delinquency.

The following table summarizes loan delinquency in total dollars and as a percentage of the total loan portfolio:

	At December 31, 2012	At December 31, 2011
	(Dollars in Thousands)	
Loans past due less than 90 days	$ 23,092	36,798
Loans past due 90 days or more	51,358	56,612
Total loans past due	$ 74,450	93,410
Total loans past due to total loans receivable	6.57%	7.68%

Total loans past due decreased by $19.0 million, or 20.3%, to $74.5 million at December 31, 2012 from $93.4 million at December 31, 2011. Loans past due less than 90 days decreased by $13.7 million, or 37.3%, during the year ended December 31, 2012 while loans past due 90 days or more decreased by $5.3 million, or 9.3%.

Real Estate Owned.

Total real estate owned decreased by $20.7 million, or 36.5%, to $36.0 million at December 31, 2012, compared to $56.7 million at December 31, 2011. During the year ended December 31, 2012, $22.3 million was transferred from loans to real estate owned upon completion of foreclosure. Declines in property values evidenced by updated appraisals, responses to list prices on properties held for sale and/or deterioration in the condition of properties resulted in write-downs totaling $7.6 million during the year ended December 31, 2012. During the same period, sales of real estate owned totaled $35.2 million. New appraisals received on real estate owned and collateral dependent impaired loans are based upon an “as is value” assumption. During the period of time in which we are awaiting receipt of an updated appraisal, loans evaluated for impairment based upon collateral value are measured by the following:

- Applying an updated adjustment factor (as described previously) to an existing appraisal;
- Confirming that the physical condition of the real estate has not significantly changed since the last valuation date;
- Comparing the estimated current value of the collateral to that of updated sales values experienced on similar collateral;
- Comparing the estimated current value of the collateral to that of updated values seen on current appraisals of similar collateral; and
- Comparing the estimated current value to that of updated listed sales prices on our real estate owned and that of similar properties (not owned by the Company).

We owned 223 properties as of December 31, 2012, compared to 323 properties at December 31, 2011. Of the $36.0 million in real estate owned properties as of December 31, 2012, $28.9 million consist of one– to four-family, over four-family and commercial real estate properties. Of all real estate owned, these property types present the greatest opportunity to offset operating expenses through the generation of rental income. Of the $28.9 million in one- to four-family, over four-family and commercial real estate properties, $13.6 million, or 47.2%, represent properties that are generating rental revenue or are being managed with the intent of attracting a lessee to generate revenue. Foreclosed properties are recorded at the lower of carrying value or fair value with charge-offs, if any, charged to the allowance for loan losses upon transfer to real estate owned. The fair value is primarily based upon updated appraisals in addition to an analysis of current real estate market conditions.

Allowance for Loan Losses

We establish valuation allowances on loans that are deemed to be impaired. A loan is considered impaired when, based on current information and events, it is probable that we will not be able to collect all amounts due according to the contractual terms of the loan agreement. A valuation allowance is established for an amount equal to the impairment when the carrying amount of the loan exceeds the present value of the expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral.

We also establish valuation allowances based on an evaluation of the various risk components that are inherent in the loan portfolio. The risk components that are evaluated include past loan loss experience; the level of non-performing and classified assets; current economic conditions; volume, growth, and composition of the loan portfolio; adverse situations that may affect the borrower's ability to repay; the estimated value of any underlying collateral; regulatory guidance; and other relevant factors. The allowance is increased by provisions charged to earnings and recoveries of previously charged-off loans and reduced by charge-offs. The appropriateness of the allowance for loan losses is reviewed and approved quarterly by the WaterStone Bank board of directors. The allowance reflects management's best estimate of the amount needed to provide for the probable loss on impaired loans and other inherent losses in the loan portfolio, and is based on a risk model developed and implemented by management and approved by the WaterStone Bank board of directors.

Actual results could differ from this estimate, and future additions to the allowance may be necessary based on unforeseen changes in loan quality and economic conditions. In addition, the Federal Deposit Insurance Corporation and the Wisconsin Department of Financial Institutions, as an integral part of their examination process, periodically review WaterStone Bank's allowance for loan losses. Such regulators have the authority to require WaterStone Bank to recognize additions to the allowance based on their judgments of information available to them at the time of their review or examination.

Any loan that is 90 or more days past due is placed on non-accrual and classified as a non-performing asset. A loan is classified as impaired when it is probable that we will be unable to collect all amounts due in accordance with the terms of the loan agreement. Non-performing assets are then evaluated and accounted for in accordance with generally accepted accounting principles.

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

	At or for the Year Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars in Thousands)				
Balance at beginning of year	$ 32,430	$ 29,175	28,494	25,167	12,839
Provision for loan losses	8,300	22,077	25,832	26,687	37,629
Charge-offs:					
Mortgage loans					
One- to four-family	6,472	11,553	16,906	13,602	8,397
Over four-family	1,108	3,996	3,439	3,304	10,056
Home equity	485	634	619	861	394
Construction and land	1,668	1,745	2,319	3,957	5,088
Commercial real estate	1,182	734	575	910	1,838
Consumer	4	10	13	9	4
Commercial	59	619	1,470	1,000	-
Total charge-offs	10,978	19,291	25,341	23,643	25,777
Recoveries:					
Mortgage loans					
One- to four-family	667	311	127	181	313
Over four-family	56	40	55	23	31
Home equity	25	7	3	1	1
Construction and land	250	69	2	77	125
Commercial real estate	-	6	1	-	-
Consumer	-	1	1	1	6
Commercial	293	35	1	-	-
Total recoveries	1,291	469	190	283	476
Net charge-offs	9,687	18,822	25,151	23,360	25,301
Allowance at end of year	$ 31,043	$ 32,430	29,175	28,494	25,167
Ratios:					
Allowance for loan losses to non-performing loans at end of year	41.58%	41.46%	34.66%	37.83%	23.36%
Allowance for loan losses to net loans outstanding at end of year	2.74%	2.67%	2.23%	2.01%	1.61%
Net charge-offs to average loans outstanding	0.76%	1.43%	1.75%	1.54%	1.67%
Current year provision for loan losses to net charge-offs	85.68%	117.29%	102.71%	114.24%	148.73%
Net charge-offs to beginning of the year allowance	29.87%	64.51%	88.27%	92.82%	197.06%

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

	At December 31,								
	2012			2011			2010		
	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance
	(Dollars in Thousands)								
Real Estate:									
Residential									
One- to four-family	$ 17,819	40.65%	57.40%	$ 17,475	39.71%	53.89%	$ 16,150	43.34%	55.36%
Over four-family	7,734	45.37%	24.90%	8,252	43.95%	25.44%	6,877	40.26%	23.57%
Home equity	2,097	3.22%	6.76%	1,998	4.78%	6.16%	1,196	5.34%	4.10%
Construction and land	1,323	2.98%	4.26%	2,922	3.60%	9.01%	3,252	4.21%	11.14%
Commercial Real Estate	1,259	5.78%	4.06%	941	5.21%	2.90%	671	3.84%	2.30%
Commercial	781	1.99%	2.52%	814	2.74%	2.51%	1,001	3.00%	3.43%
Consumer	30	0.01%	0.10%	28	0.01%	0.09%	28	0.01%	0.10%
Total allowance for loan losses	$ 31,043	100.00%	100.00%	$ 32,430	100.00%	100.00%	$ 29,175	100.00%	100.00%

	At December 31,					
	2009			2008		
	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance	Allowance for Loan Losses	% of Loans in Category to Total Loans	% of Allowance in Category to Total Allowance
	(Dollars In Thousands)					
Real Estate:						
Residential						
One- to four-family	$ 17,875	46.31%	62.73%	$ 14,218	48.70%	56.49%
Over four-family	5,208	36.47%	18.28%	6,844	31.59%	27.20%
Home equity	1,642	5.84%	5.76%	1,027	5.52%	4.08%
Construction and land	2,635	4.74%	9.25%	2,137	8.12%	8.49%
Commercial Real Estate	720	3.33%	2.53%	445	3.40%	1.77%
Commercial	371	3.27%	1.30%	457	2.65%	1.82%
Consumer	43	0.04%	0.15%	39	0.02%	0.15%
Total allowance for loan losses	$ 28,494	100.00%	100.00%	$ 25,167	100.00%	100.00%

All impaired loans meeting the criteria established by management are evaluated either individually, based primarily on the value of the collateral securing each loan and the ability of the borrowers to repay according to the terms of the loans, or based upon an analysis of the present value of the expected future cash flows under the original contract terms as compared to the modified terms in the case of certain troubled debt restructurings. Specific loss allowances are established as required by this analysis. At least once each quarter, management evaluates the appropriateness of the balance of the allowance for loan losses based on several factors some of which are not loan specific, but are reflective of the inherent losses in the loan portfolio. This process includes, but is not limited to, a periodic review of loan collectability in light of historical experience, the nature and volume of loan activity, conditions that may affect the ability of the borrower to repay, underlying value of collateral and economic conditions in our immediate market area. All loans for which a specific loss review is not required are segregated by loan type and a loss allowance is established by using loss experience data and management's judgment concerning other matters it considers significant including trends in non-performing loan balances, impaired loan balances, classified asset balances and the current economic environment. The allowance is allocated to each category of loans based on the results of the above analysis.

The above analysis is both quantitative and subjective, as it requires us to make estimates that are susceptible to revisions as more information becomes available. Although we believe that we have established the allowance at levels appropriate to absorb probable and estimable losses, additions may be necessary if future economic conditions differ substantially from the current environment.

At December 31, 2012, the allowance for loan losses was $31.0 million, compared to $32.4 million at December 31, 2011. As of December 31, 2012, the allowance for loan losses to total loans receivable was 2.74% and was equal to 41.58% of non-performing loans, compared to 2.67% and 41.46%, respectively, at December 31, 2011. The $1.4 million decrease in the allowance for loan losses during the year ended December 31, 2012 reflects a stabilization in both the quality of the loan portfolio as well as the overall local real estate market. The Company has experienced a stabilization or improvement in a number of key loan-related loan quality metrics compared to December 31, 2011, including impaired loans, substandard loans, loans contractually past due and non-accrual loans. In addition, the decrease in the allowance for loan losses reflects a decrease in the overall balance of loans outstanding.

Net charge-offs totaled $9.7 million, or 0.76% of average loans for the year ended December 31, 2012, compared to $18.8 million, or 1.43% of average loans for the year ended December 31, 2011. The decrease in net charge-offs was primarily the result of a decrease in charge-offs related to loans secured by one- to four-family and over four-family residential loans. Net charge-offs related to loans secured by one- to four-family residential loans totaled decreased $5.4 million, or 48.4%, to $5.8 million for the year ended December 31, 2012, as compared to $11.2 million for the year ended December 31, 2011. Net charge-offs related to loans secured by over four-family residential loans totaled decreased $2.9 million, or 73.4%, to $1.1 million for the year ended December 31, 2012, as compared to $4.0 million for the year ended December 31, 2011. The decrease in net charge-offs during the year ended December 31, 2012 reflects a stabilization in both the quality of the loan portfolio as well as the overall local real estate market.

The $8.3 million loan loss provision for the year ended December 31, 2012 reflects our determination that the allowance for loan losses should total $31.0 million following the net charge-offs recorded during the period and a review of the our loan portfolio and general economic conditions.

Our underwriting policies and procedures emphasize the fact that credit decisions must rely on both the credit quality of the borrower and the estimated value of the underlying collateral. Credit quality is assured only when the estimated value of the collateral is objectively determined and is not subject to significant fluctuation. The quantified deterioration of the credit quality of our loan portfolio as described above is the direct result of borrowers who were not financially strong enough to make regular interest and principal payments or maintain their properties when the economic environment no longer allowed them the option of converting estimated real estate value increases into short-term cash flow.

Mortgage Banking Activity

In addition to the lending activities previously discussed, we also originate residential mortgage loans for the purpose of sale on the secondary market. We originated $1.75 billion in mortgage loans held for sale during the year ended December 31, 2012 as compared to $1.03 billion during the year ended December 31, 2011. Proceeds from sales to third parties during the year ended December 31, 2012 totaled $1.79 billion as compared to $1.07 billion during the year ended December 31, 2011. This activity generated approximately $87.4 million and $39.8 million in mortgage banking income for the periods ended December 31, 2012 and 2011, respectively. Driven by an increase in both loan origination volume and sales margin, net income related to this segment increased by $9.9 million to $11.5 million during the year ended December 31, 2012 compared to $1.7 million during the year ended December 31, 2011. We sell loans on both a servicing-released and a servicing retained basis. Waterstone Mortgage has contracted with a third party to service the loans for which we retain servicing.

Despite higher market interest rates during 2012, overall loan origination volumes increased significantly compared to 2011, which reflects the continued strong demand for fixed-rate loans due in large part to historically low interest rates on these products. Loans originated for sale on the secondary market totaled $1.75 billion during the year ended December 31, 2012, which represents a $722.1 million, or 70.3%, increase in originations from the year ended December 31, 2011, which totaled $1.03 million.

Our overall margin can be affected by the mix of both loan type (conventional loans versus governmental) and loan purpose (purchase versus refinance). Conventional loans include loans that conform to Fannie Mae and Freddie Mac standards, whereas governmental loans are those loans guaranteed by the federal government, such as a Federal Housing Authority or U.S. Department of Agriculture loan. During the year ended December 31, 2012, the growth in loan origination volume resulted in a shift towards lower yielding conventional loans and loans made for the purpose of a refinancing, however, margins increased for all loan types and loan purpose, compared to the year ended December 31, 2011. Loans originated for the purpose of a residential property purchase, which generally yield a higher margin than loans originated for the purpose of a refinance, comprised 55.4% of total originations during the year ended December 31, 2012, compared to 65.1% during the year ended December 31, 2011. The mix of loan type changed slightly with conventional loans and governmental loans comprising 67.3% and 32.7% of all loan originations, respectively, during the year ended December 31, 2012. During the year ended December 31, 2011 conventional loans and governmental loans comprised 61.6% and 38.4% of all loan originations, respectively.

Compensation expense associated with our mortgage banking activities increased $23.8 million, or 88.5%, to $50.7 million for the year ended December 31, 2012 compared to $26.9 million during the year ended December 31, 2011. The increase resulted from both an increase in commissions earned on the higher margin sales noted above, as well as an increase in administrative compensation expenses that resulted from an increase in origination volumes. Occupancy expense increased $630,000, or 19.5%, to $3.9 million during the year ended December 31, 2012 as compared to $3.2 million during the year ended December 31, 2011. The increase resulted from an expansion of the branch network that occurred primarily throughout the year ended December 31, 2011. The year ended December 31, 2012 now reflects a full year of expense related to those locations. Other noninterest expense increased $6.6 million, or 84.1%, to $14.5 million during the year ended December 31, 2012 as compared to $7.9 million during the year ended December 31, 2011. The increase resulted from the significant increase in origination volumes during the year ended December 31, 2012.

Investment Activities

Wauwatosa Investments, Inc. is WaterStone Bank's investment subsidiary headquartered in the State of Nevada. Wauwatosa Investments, Inc. manages WaterStone Bank's investment portfolio. Our Treasurer and Treasury Officer are responsible for implementing our investment policy and monitoring the investment activities of Wauwatosa Investments, Inc. The investment policy is reviewed annually by management and changes to the policy are recommended to and subject to the approval of our board of directors. Authority to make investments under the approved investment policy guidelines is delegated by the board to designated employees. While general investment strategies are developed and authorized by management, the execution of specific actions rests with the Treasurer and Treasury Officer who may act jointly or severally. In addition, the President of Wauwatosa Investments, Inc. has execution authority for securities transactions. The Treasurer and Treasury Officer are responsible for ensuring that the guidelines and requirements included in the investment policy are followed and that all securities are considered prudent for investment. The Treasurer, the Treasury Officer and the President of Wauwatosa Investments, Inc. are authorized to execute investment transactions (purchases and sales) without the prior approval of the board and within the scope of the established Investment Policy.

Our investment policy requires that all securities transactions be conducted in a safe and sound manner. Investment decisions are based upon a thorough analysis of each security instrument to determine its quality, inherent risks, fit within our overall asset/liability management objectives, effect on our risk-based capital measurement and prospects for yield and/or appreciation.

Consistent with our overall business and asset/liability management strategy, which focuses on sustaining adequate levels of core earnings, our investment portfolio is comprised primarily of securities that are classified as available for sale. During the year ended December 31, 2012, collateralized mortgage obligations with a total book value of $18.0 million were sold at a gain of $282,000 and municipal securities with a total book value of $11.6 million were sold at a gain of $240,000. During the year ended December 31, 2011, collateralized mortgage obligations with a total book value of $3.2 million were sold at a gain of $53,000. During the year ended December 31, 2010, municipal securities with a total book value of $14.0 million were sold at a gain of $11,000. During the same period, collateralized mortgage obligations with a total book value of $6.7 million were sold at a gain of $44,000.

Available for Sale Portfolio

Government Sponsored Enterprise Bonds. At December 31, 2012, our Government sponsored enterprise bond portfolio totaled $8.0 million, all of which were issued by Federal National Mortgage Associated (Fannie Mae) and were classified as available for sale. The weighted average yield on these securities was 0.70% and the weighted average remaining average life was 3.9 years at December 31, 2012. While these securities generally provide lower yields than other investments in our securities investment portfolio, we maintain these investments, to the extent appropriate, for liquidity purposes and prepayment protection. The estimated fair value of our government sponsored enterprise bond portfolio at December 31, 2012 was $17,000 more than the amortized cost of $8.0 million. A total of $6.1 million of government enterprise bonds are pledged as collateral for borrowings at December 31, 2012.

Mortgage-backed Securities and Collateralized Mortgage Obligations. We purchase mortgage-backed securities and collateralized mortgage obligations guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae and collateralized mortgage obligations issued by investment banks. We invest in mortgage-backed securities and collateralized mortgage obligations to achieve positive interest rate spreads with minimal administrative expense, and to lower our credit risk. We regularly monitor the credit quality of this portfolio.

Mortgage-backed securities and collateralized mortgage obligations are created by the pooling of mortgages and the issuance of a security with an interest rate which is less than the interest rate on the underlying mortgages. These securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although we focus our investments on mortgage related securities backed by one- to four-family mortgages. The issuers of such securities pool and resell the participation interests in the form of securities to investors such as WaterStone Bank, and in the case of government agency sponsored issues, guarantee the payment of principal and interest to investors. Mortgage-backed securities and collateralized mortgage obligations generally yield less than the loans that underlie such securities because of the cost of payment guarantees, if any, and credit enhancements. These fixed-rate securities are usually more liquid than individual mortgage loans.

At December 31, 2012, mortgage-backed securities totaled $119.1 million. The mortgage-backed securities portfolio had a weighted average yield of 2.00% and a weighted average remaining life of 3.8 years at December 31, 2012. The estimated fair value of our mortgage-backed securities portfolio at December 31, 2012 was $2.2 million more than the amortized cost of $116.8 million. Mortgage-backed securities valued at $66.3 million are pledged as collateral for borrowings at December 31, 2012. Investments in mortgage-backed securities involve a risk that actual prepayments may differ from estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or if such securities are redeemed by the issuer. In addition, the market value of such securities may be adversely affected in a rising interest rate environment, particularly since all of our mortgage-backed securities have a fixed rate of interest. The relatively short weighted average remaining life of our mortgage-backed security portfolio mitigates our potential risk of loss in a rising interest rate environment.

At December 31, 2012, collateralized mortgage obligations totaled $29.6 million. At December 31, 2012, the collateralized mortgage obligations portfolio consisted entirely of securities backed by government sponsored enterprises or U.S. Government agencies.

The collateralized mortgage obligations portfolio had a weighted average yield of 2.26% and a weighted average remaining life of 2.0 years at December 31, 2012. The estimated fair value of our collateralized mortgage obligations portfolio at December 31, 2012 was $372,000 more than the amortized cost of $29.2 million. Collateralized mortgage obligations valued at $29.6 million are pledged as collateral for borrowings at December 31, 2012. Investments in collateralized mortgage obligations involve a risk that actual prepayments may differ from estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby changing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or if such securities are redeemed by the issuer. In addition, the market value of such securities may be adversely affected in a rising interest rate environment, particularly since all of our collateralized mortgage obligations have a fixed rate of interest. The relatively short weighted average remaining life of our collateralized mortgage obligation portfolio mitigates our potential risk of loss in a rising interest rate environment.

At December 31, 2012, we held no private-label collateralized mortgage obligations. During the year ended December 31, 2012, we held two private-label collateralized mortgage obligation securities that were other-than-temporarily impaired. Estimates of discounted cash flows based on expected yield at time of original purchase, prepayment assumptions based on actual and anticipated prepayment speed, actual and anticipated default rates and estimated level of severity given the loan to value ratios, credit scores, geographic locations, vintage and levels of subordination related to the security and its underlying collateral resulted in a projected credit loss on the collateralized mortgage obligations. During the year ended December 31, 2012, our analysis resulted in an additional $113,000 in credit losses that were charged to earnings with respect to one of these two collateralized mortgage obligations. During the year ended December 31, 2012, the two aforementioned private-label collateralized mortgage obligations were sold at a combined gain of $282,000. At the time of sale, these securities had a combined amortized cost of $18.0 million. Life-to-date other than temporary impairment losses recognized totaled $2.2 million.

Municipal Obligations. These securities consist of obligations issued by school districts, counties and municipalities or their agencies and include general obligation bonds, industrial development revenue bonds and other revenue bonds. Our Investment Policy requires that such municipal obligations be rated A+ or better by a nationally recognized rating agency at the date of purchase. A security that is downgraded below investment grade will require additional analysis of creditworthiness and a determination will be made to hold or dispose of the investment. At December 31, 2012, our municipal obligations portfolio totaled $37.4 million, all of which was classified as available for sale. The weighted average yield on this portfolio was 4.44% at December 31, 2012, with a weighted average remaining life of 9.5 years. The estimated market value of our municipal obligations bond portfolio at December 31, 2012 was $1.9 million more than the amortized cost of $35.5 million. During the year ended December 31, 2012, the Company identified two municipal securities that were deemed to be other-than-temporarily impaired. Both securities were issued by a tax incremental district in a municipality located in Wisconsin. The Company's analysis of these securities resulted in $100,000 in credit losses that were charged to earnings with respect to these two municipal securities. As of December 31, 2012, these securities had a combined amortized cost of $215,000 and a combined estimated fair value of $237,000.

Other Debt Securities. As of December 31, 2012, we held a trust preferred security with a fair value of $5.1 million and amortized cost of $5.0 million. This security, which yields 10.0% is callable beginning in the second quarter of 2013 with final maturity in 2068.

Certificates of Deposit. At December 31, 2012, we held certificates of deposit with a fair value and amortized cost of $5.9 million. The weighted average yield on these securities was 0.97% and the weighted average remaining average life was 1.6 years at December 31, 2012. While these certificates generally provide lower yields than other investments in our securities investment portfolio, we maintain these investments, to the extent appropriate, for liquidity purposes and prepayment protection.

Held to Maturity Portfolio

As of December 31, 2012, we did not hold any securities that were designated as held to maturity. During the year ended December 31, 2012, the one security held by us that had been designated as held to maturity was called by the issuer. This security had an amortized cost of $2.6 million at the time that it was called. The amortized cost of that security at December 31, 2011 and 2010 was $2.6 million and its fair value was $2.5 million.

Investment Securities Portfolio.

The following table sets forth the carrying values of our available for sale securities portfolio at the dates indicated.

	At December 31,					
	2012		2011		2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)					
Securities available for sale:						
Mortgage-backed securities	$ 116,813	119,056	33,561	35,417	42,607	44,330
Collateralized mortgage obligations						
Government sponsored enterprise issued	29,207	29,579	32,650	33,196	38,262	39,277
Private label issued	-	-	19,475	18,451	26,199	25,447
Government sponsored enterprise bonds	8,000	8,017	71,210	71,349	57,327	57,698
Municipal obligations	35,493	37,371	37,644	39,068	31,804	31,120
Other debt securities	5,000	5,070	5,000	5,118	5,000	5,294
Certificates of deposit	5,880	5,924	3,920	3,920	-	-
Total securities available for sale	$ 200,393	205,017	203,460	206,519	201,199	203,166

The following table sets forth the amortized cost and estimated fair value of securities, by issuer, as of December 31, 2012, that exceeded 10% of our stockholders' equity as of that date.

	At December 31, 2012	
	Amortized Cost	Fair Value
	(In Thousands)	
Fannie Mae......................................	$ 103,448	$ 105,120
Freddie Mac	46,416	47,240

Portfolio Maturities and Yields. The composition and maturities of the securities portfolio at December 31, 2012 are summarized in the following table. Maturities are based on the final contractual payment dates and do not reflect the impact of prepayments or early redemptions that may occur. Municipal obligation yields have not been adjusted to a tax-equivalent basis. Certain mortgage related securities have interest rates that are adjustable and will reprice annually within the various maturity ranges. These repricing schedules are not reflected in the table below.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
	(Dollars in Thousands)									
Securities available for sale:										
Mortgage-backed securities	-	-	106,347	2.04%	10,172	1.33%	2,537	3.31%	119,056	2.00%
Collateralized mortgage obligations										
Government sponsored enterprise issued	$1,852	4.42%	27,727	2.11%	-	-	-	-	29,579	2.26%
Government sponsored enterprise bonds	-	-	8,017	0.70%	-	-	-	-	8,017	0.70%
Municipal obligations	967	1.73%	11,400	4.61%	10,288	2.88%	14,716	5.65%	37,371	4.44%
Other debt securities	-	-	-	-	-	-	5,070	10.00%	5,070	10.00%
Certificates of deposit	1,964	0.69%	3,960	1.11%	-	-	-	-	5,924	0.97%
Total securities available for sale	$4,783	2.34%	157,451	2.13%	20,460	2.11%	22,323	6.39%	205,017	2.59%

Sources of Funds

General. Deposits have traditionally been our primary source of funds for use in lending and investment activities. We also rely on advances from the Federal Home Loan Bank of Chicago and borrowings from other commercial banks in the form of repurchase agreements collateralized by investment securities. In addition to deposits and borrowings, we derive funds from scheduled loan payments, investment maturities, loan prepayments, retained earnings and income on earning assets. While scheduled loan payments and income on earning assets are relatively stable sources of funds, deposit inflows and outflows can vary widely and are influenced by prevailing market interest rates, economic conditions and competition from other financial institutions.

Deposits. A majority of our depositors are persons who work or reside in Milwaukee and Waukesha Counties and, to a lesser extent, other southeastern Wisconsin communities. We offer a selection of deposit instruments, including checking, savings, money market deposit accounts, and fixed-term certificates of deposit. Deposit account terms vary, with the principal differences being the minimum balance required, the amount of time the funds must remain on deposit and the interest rate. Certificates of deposit comprised 78.4% of total deposits at December 31, 2012, and had a weighted average cost of 0.83% on that date. Our reliance on certificates of deposit has resulted in a higher cost of funds than would otherwise be the case if demand deposits, savings and money market accounts made up a larger part of our deposit base. Development of our branch network and expansion of our commercial products and services are expected to result in decreased reliance on higher cost certificates of deposit in the long-term by aggressively seeking lower cost savings, checking and money market accounts.

Interest rates paid, maturity terms, service fees and withdrawal penalties are established on a periodic basis. Deposit rates and terms are based primarily on current operating strategies and market rates, liquidity requirements, rates paid by competitors and growth goals. To attract and retain deposits, we rely upon personalized customer service, long-standing relationships and competitive interest rates.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and other prevailing interest rates and competition. The variety of deposit accounts that we offer allows us to be competitive in obtaining funds and responding to changes in consumer demand. Based on historical experience, management believes our deposits are relatively stable. The ability to attract and maintain money market accounts and certificates of deposit, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions. At December 31, 2012 and December 31, 2011, $736.9 million and $878.7 million, or 78.4% and 83.6%, respectively, of our deposit accounts were certificates of deposit, of which $454.6 million and $787.9 million, respectively, had maturities of one year or less. The percentage of our deposit accounts that are certificates of deposit is greater than most of our competitors.

Total deposits decreased by $111.8 million, or 10.6%, from December 31, 2011 to December 31, 2012. This net decrease was the result of a $141.8 million, or 16.1%, decrease in certificates of deposit, which was partially offset by a $15.7 million, or 22.9%, increase in demand deposits and a $14.4 million, or 13.8%, increase in money market and savings accounts.

Deposits obtained from brokers totaled $100,000 and $399,000 million at December 31, 2012 and 2011, respectively. Brokered deposits have historically been utilized when the relative cost compares favorably to the cost of retail deposits we generate directly. Brokered deposits have also been historically utilized in order to obtain significant additional deposit funding over a period of weeks rather than months.

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

	At December 31,								
	2012			2011			2010		
	Balance	**Percent**	**Weighted Average Rate**	**Balance**	**Percent**	**Weighted Average Rate**	**Balance**	**Percent**	**Weighted Average Rate**
	(Dollars in Thousands)								
Deposit type:									
Demand deposits	$39,767	4.23%	0.00%	$28,812	2.74%	0.00%	$30,030	2.62%	0.00%
NOW accounts	44,373	4.72%	0.03%	39,645	3.77%	0.08%	37,705	3.29%	0.08%
Regular savings	54,837	5.84%	0.10%	45,511	4.33%	0.20%	44,540	3.89%	0.22%
Money market and savings deposits	63,616	6.77%	0.15%	58,591	5.57%	0.41%	58,863	5.14%	0.48%
Total transaction accounts	202,593	21.56%	0.08%	172,559	16.41%	0.21%	171,138	14.94%	0.24%
Certificates of deposit	736,920	78.44%	0.83%	878,733	83.59%	1.53%	974,391	85.06%	1.74%
Total deposits	$939,513	100.00%	0.67%	$1,051,292	100.00%	1.31%	$1,145,529	100.00%	1.51%

At December 31, 2012, the aggregate balance of certificates of deposit of $100,000 or more was approximately $193.6 million. The following table sets forth the maturity of those certificates at December 31, 2012.

Due in:	(In Thousands)
Three months or less	$23,176
Over three months through six months	47,879
Over six months through 12 months	46,500
Over 12 months	76,001
Total	$193,556

The following table sets forth all of our certificates of deposit classified by interest rate as of the dates indicated.

	At December 31,		
	2012	2011	2010
	(In thousands)		
Interest Rate:			
Less than 1%	$ 562,186	177,225	56,294
1.00% to 1.99%	162,541	588,989	771,822
2.00% to 2.99%	10,681	92,330	111,511
3.00% to 3.99%	1,512	4,929	8,840
4.00% to 4.99%	—	14,757	25,060
5.00% to 5.99%	—	503	864
Total	$ 736,920	878,733	974,391

The following table sets forth the amount and maturities of all our certificates of deposit by interest rate at December 31, 2012.

	At December 31, 2012					
	Period to Maturity					
	One Year or Less	Over One Year to Two Years	Over Two Years to Three Years	Over Three Years	Total	Percentage of Total Certificate Accounts
	(Dollars in thousands)					
Interest Rate:						
Less than 1%	$380,672	179,832	1,681	1	562,186	76.3%
1.00% to 1.99%	71,166	54,522	6,317	30,536	162,541	22.1
2.00% to 2.99%	1,213	2,460	7,008	—	10,681	1.4
3.00% to 3.99%	1,510	2	—	—	1,512	0.2
4.00% to 4.99%	—	—	—	—	—	—
5.00% to 5.99%	—	—	—	—	—	—
Total	$454,561	236,816	15,006	30,537	736,920	100.0%

Borrowings. Our borrowings at December 31, 2012 consist of $350.0 million in advances from the Federal Home Loan Bank of Chicago, $84.0 million in repurchase agreements collateralized by investment securities and $45.9 million in short-term repurchase agreements used to finance loans held for sale. The following table sets forth information concerning balances and interest rates on borrowings at the dates and for the periods indicated.

	At or For the Year Ended December 31,		
	2012	**2011**	**2010**
Borrowings:	(Dollars in Thousands)		
Balance outstanding at end of period	$ 479,888	$ 461,138	$ 456,959
Weighted average interest rate at the end of period	3.82%	3.93%	3.94%
Maximum amount of borrowings outstanding at any month end during the period	491,053	465,290	506,902
Average balance outstanding during the period	475,114	446,401	481,808
Weighted average interest rate during the period	3.87%	3.93%	4.03%

Legal Proceedings

The Company and its subsidiaries are not involved in any legal proceedings where the outcome, if adverse to us, would have a material and adverse affect on our financial condition or results of operations.

Subsidiary Activities

Waterstone Financial currently has one wholly-owned subsidiary, WaterStone Bank, which in turn has three wholly-owned subsidiaries. Wauwatosa Investments, Inc., which holds and manages our investment portfolio, is located and incorporated in the state of Nevada. Waterstone Mortgage Corporation is a mortgage banking business incorporated in Wisconsin. Main Street Real Estate Holdings, LLC, is an inactive Wisconsin limited liability corporation and previously owned Bank office facilities and held Bank office facility leases.

Wauwatosa Investments, Inc. Established in 1998, Wauwatosa Investments, Inc. operates in Nevada as WaterStone Bank's investment subsidiary. This wholly-owned subsidiary owns and manages the majority of the consolidated investment portfolio. It has its own board of directors currently comprised of its President, the WaterStone Bank Chief Financial Officer, Treasury Officer and the Chairman of the Company's board of directors.

Waterstone Mortgage Corporation. Acquired in February 2006, Waterstone Mortgage Corporation is a mortgage banking business with offices in Wisconsin, Pennsylvania, Minnesota, Florida, Ohio, Arizona, Idaho, Indiana, Iowa, Illinois and Maryland. Waterstone Mortgage Corporation was the largest mortgage broker in the Milwaukee area based on 2012 dollar volume of retail first and second mortgages originated. It has its own board of directors currently comprised of its President, its CFO, the WaterStone Bank CEO, CFO and General Counsel.

Main Street Real Estate Holdings, LLC. Established in 2002, Main Street Real Estate Holdings, LLC was established to acquire and hold Bank office and retail facilities both owned and leased. Main Street Real Estate Holdings, LLC is currently inactive, but we have filed an application with the WDFI to permit Main Street Real Estate Holdings, LLC to conduct real estate broker activities limited to real estate owned, bank-owned branch office facilities and real estate securing loans.

Personnel

As of December 31, 2012, we had 726 full-time equivalent employees. Our employees are not represented by any collective bargaining group. Management believes that we have good working relations with our employees.

Supervision and Regulation

The following discussion is only a summary of the primary laws and regulations affecting the powers and operations of WaterStone Bank, Waterstone Financial, and Lamplighter Financial, MHC. It is not intended to be a comprehensive description of all laws and regulations applicable to these entities and is qualified in its entirety by reference to the applicable laws and regulations.

Regulation of WaterStone Bank

WaterStone Bank is a stock savings bank organized under the laws of the State of Wisconsin. The lending, investment, and other business operations of WaterStone Bank are governed by Wisconsin law and regulations, as well as applicable federal law and regulations, and WaterStone Bank is prohibited from engaging in any operations not authorized by such laws and regulations. WaterStone Bank is subject to extensive regulation by the Wisconsin Department of Financial Institutions, Division of Banking (“WDFI”) and by the Federal Deposit Insurance Corporation (“FDIC”), as its deposit insurer and primary federal regulator. WaterStone Bank’s deposit accounts are insured up to applicable limits by the FDIC under its Deposit Insurance Fund (“DIF”). A summary of the primary laws and regulations that govern the operations of WaterStone Bank are set forth below.

Intrastate and Interstate Merger and Branching Activities

Wisconsin Law and Regulation. Any Wisconsin savings bank meeting certain requirements may, upon approval of the WDFI, establish one or more branch offices in the state of Wisconsin or the states of Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, and Ohio. In addition, upon WDFI approval, a Wisconsin savings bank may establish a branch office in any other state as the result of a merger or consolidation.

Federal Law and Regulation. The Interstate Banking Act (the "IBA") permits the federal banking agencies to, under certain circumstances, approve acquisition transactions between banks located in different states, regardless of whether an acquisition would be prohibited under state law. The IBA, as amended, authorizes *de novo* branching into another state at locations at which banks chartered by the host state could establish a branch. Additionally, the IBA authorizes branching by merger, subject to certain state law limitations.

Loans and Investments

Wisconsin Law and Regulations. Under Wisconsin law and regulation, WaterStone Bank is authorized to make, invest in, sell, purchase, participate or otherwise deal in mortgage loans or interests in mortgage loans without geographic restriction, including loans made on the security of residential and commercial property. Wisconsin savings banks also may lend funds on a secured or unsecured basis for business, commercial or agricultural purposes, provided the total of all such loans does not exceed 20% of WaterStone Bank's total assets, unless the WDFI authorizes a greater amount. Loans are subject to certain other limitations, including percentage restrictions based on WaterStone Bank's total assets.

Wisconsin savings banks may invest funds in certain types of debt and equity securities, including obligations of federal, state and local governments and agencies. Subject to prior approval of the WDFI, compliance with capital requirements and certain other restrictions, Wisconsin savings banks may invest in residential housing development projects. Wisconsin savings banks may also invest in service corporations or subsidiaries with the prior approval of the WDFI, subject to certain restrictions.

Wisconsin savings banks may make loans and extensions of credit, both direct and indirect, to one borrower in amounts up to 15% of WaterStone Bank's capital plus an additional 10% for loans fully secured by readily marketable collateral. In addition, and notwithstanding the 15% of capital and additional 10% of capital limitations set forth above, Wisconsin savings banks may make loans to one borrower, or a related group of borrowers, for any purpose in an amount not to exceed $500,000, or to develop domestic residential housing units in an amount not to exceed the lesser of $30 million or 30% of WaterStone Bank's capital, subject to certain conditions. At December 31, 2012, WaterStone Bank did not have any loans which exceeded the "loans-to-one borrower" limitations.

Finally, under Wisconsin law, WaterStone Bank must qualify for and maintain a level of qualified thrift investments equal to 60% of its assets as prescribed in Section 7701(a)(19) of the Internal Revenue Code of 1986, as amended. A Wisconsin savings bank that fails to meet this qualified thrift lender test becomes subject to certain operating restrictions otherwise applicable only to commercial banks. At December 31, 2012, WaterStone Bank maintained 99.7% of its assets in qualified thrift investments and therefore met the qualified thrift lender requirement.

Federal Law and Regulation. FDIC regulations also govern the equity investments of WaterStone Bank, and, notwithstanding Wisconsin law and regulations, FDIC regulations prohibit WaterStone Bank from making certain equity investments and generally limit WaterStone Bank's equity investments to those that are permissible for national banks and their subsidiaries. Under FDIC regulations, WaterStone Bank must obtain prior FDIC approval before directly, or indirectly through a majority-owned subsidiary, engaging "as principal" in any activity that is not permissible for a national bank unless certain exceptions apply. The activity regulations provide that state banks that meet applicable minimum capital requirements would be permitted to engage in certain activities that are not permissible for national banks, including certain real estate and securities activities conducted through subsidiaries. The FDIC will not approve an activity that it determines presents a significant risk to the FDIC insurance fund. The activities of WaterStone Bank and its subsidiaries are permissible under applicable federal regulations.

Loans to, and other transactions with, affiliates of WaterStone Bank, such as Waterstone Financial and Lamplighter Financial, MHC, are restricted by the Federal Reserve Act and regulations issued by the FRB thereunder. See "Transactions with Affiliates and Insiders" below.

Lending Standards

Wisconsin Law and Regulation. Wisconsin law and regulations issued by the WDFI impose on Wisconsin savings banks certain fairness in lending requirements and prohibit savings banks from discriminating against a loan applicant based upon the applicant's physical condition, developmental disability, sex, marital status, race, color, creed, national origin, religion or ancestry.

Federal Law and Regulation. The federal banking agencies adopted uniform regulations prescribing standards for extensions of credit that are secured by liens on interests in real estate or made for the purpose of financing the construction of a building or other improvements to real estate. Under the joint regulations adopted by the federal banking agencies, all insured depository institutions, such as WaterStone Bank, must adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens or interests in real estate or are made for the purpose of financing permanent improvements to real estate. These policies must establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value limits) that are clear and measurable, loan administration procedures, and documentation, approval and reporting requirements. The real estate lending policies must reflect consideration of the Interagency Guidelines for Real Estate Lending Policies that have been adopted by the federal bank regulators.

The Interagency Guidelines, among other things, require a depository institution to establish internal loan-to-value limits for real estate loans that are not in excess of the following supervisory limits:

- for loans secured by raw land, the supervisory loan-to-value limit is 65% of the value of the collateral;

- for land development loans (i.e., loans for the purpose of improving unimproved property prior to the erection of structures), the supervisory limit is 75%;

- for loans for the construction of commercial, over four-family or other non-residential property, the supervisory limit is 80%;

- for loans for the construction of one- to four-family properties, the supervisory limit is 85%; and

- for loans secured by other improved property (e.g., farmland, completed commercial property and other income-producing property, including non-owner occupied, one- to four-family property), the limit is 85%.

Although no supervisory loan-to-value limit has been established for owner-occupied, one- to four-family and home equity loans, the Interagency Guidelines state that for any such loan with a loan-to-value ratio that equals or exceeds 90% at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.

Deposits

Wisconsin Law and Regulation. Under Wisconsin law, WaterStone Bank is permitted to establish deposit accounts and accept deposits. WaterStone Bank’s board of directors, or its designee, determines the rate and amount of interest to be paid on or credited to deposit accounts subject to FDIC limitations.

Deposit Insurance

Wisconsin Law and Regulation. Under Wisconsin law, WaterStone Bank is required to obtain and maintain insurance on its deposits from a deposit insurance corporation. The deposits of WaterStone Bank are insured up to the applicable limits by the FDIC.

Federal Law and Regulation. WaterStone Bank is a member of the DIF, which is administered by the FDIC. The Bank’s deposit accounts are insured by the FDIC, generally up to a maximum of $250,000.

The Federal Deposit Insurance Corporation imposes an assessment against all depository institutions. An institution’s assessment rate depends upon the category to which it is assigned and certain adjustments specified by Federal Deposit Insurance Corporation regulations, with less risky institutions paying lower rates. Assessment rates (inclusive of possible adjustments) currently range from 2 ½ to 45 basis points of each institution’s total assets less tangible capital. The Federal Deposit Insurance Corporation may increase or decrease the range of assessments uniformly, except that no adjustment can deviate more than two basis points from the base assessment rate without notice and comment rulemaking. The Federal Deposit Insurance Corporation’s current system represents a change, required by the Dodd-Frank Act, from its prior practice of basing the assessment on an institution’s aggregate deposits.

On November 12, 2009, the FDIC issued a rule requiring all depository institutions to prepay their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. Under the rule, this prepayment was due on December 31, 2009. The assessment rate for the fourth quarter of 2009 and for 2010 was based on each institution’s total base assessment rate for the third quarter of 2009, modified to assume that the assessment rate in effect on September 30, 2009 had been in effect for the entire third quarter, and the assessment rate for 2011 and 2012 would be equal to the modified third quarter assessment rate plus an additional 3 basis points. In addition, each institution’s base assessment rate for each period was calculated using its third quarter assessment base, adjusted quarterly for an estimated 5% annual growth rate in the assessment base through the end of 2012. WaterStone Bank received a waiver from the FDIC relative to the 2010, 2011 and 2012 prepayment.

The Federal Deposit Insurance Corporation has the authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of WaterStone Bank. We cannot predict what insurance assessment rates will be in the future.

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

In addition to the FDIC assessments, the Financing Corporation (FICO) is authorized to impose and collect, with the approval of the Federal Deposit Insurance Corporation, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended December 31, 2012, the annualized FICO assessment was equal to 0.66 basis points of total assets less tangible capital.

Regulatory Development

On November 25, 2009, pursuant to a Stipulation and Consent to the Issuance of a Consent Order, WaterStone Bank agreed to the issuance of a Consent Order jointly issued by the Federal Deposit Insurance Corporation and the WDFI, WaterStone Bank's primary banking regulators. At the same time, pursuant to a Stipulation and Consent to Issuance of Order to Cease and Desist, Waterstone Financial, Inc. agreed to the issuance of an Order to Cease and Desist by the Office of Thrift Supervision, Waterstone Financial, Inc's holding company regulator at the time. Collectively, the Stipulation and Consent to the Issuance of a Consent Order which became effective on December 18, 2009 and the Stipulation and Consent to Issuance of Order to Cease and Desist which became effective on December 1, 2009; are referred to as the "Orders".

The Order issued by the Federal Deposit Insurance Corporation and the WDFI required, among other things, that WaterStone Bank (i) maintain minimum Tier 1 capital of 8.5% of total average assets and minimum total risk-based capital of 12.0% of risk-weighted assets; (ii) perform a study with respect to the management of WaterStone Bank; and (iii) manage its bad loans and real estate acquired in foreclosure. The Order issued by the Federal Deposit Insurance Corporation and the WDFI prohibited the payment of cash dividends to Waterstone Financial, Inc. without prior regulatory consent.

The Order issued by the Office of Thrift Supervision requires, among other things, that Waterstone Financial, Inc. adopt a two year capital plan that included plans for WaterStone Bank to maintain minimum Tier 1 capital of 8.5% of total average assets and minimum total risk-based capital of 12.0% of risk-weighted assets. The Order issued by the Office of Thrift Supervision also prohibited the payment of cash dividends or repurchases of common stock, and restricted the ability of Waterstone Financial, Inc. to incur debt, in each case without prior regulatory non-objection.

Effective December 11, 2012, the WDFI and the Federal Deposit Insurance Corporation terminated the Order issued to WaterStone Bank. The terminated Order was replaced with a memorandum of understanding that requires, among other things, maintenance of a minimum Tier I capital of 8.0% and a minimum total risk based capital ratio of 12.0%, and also prohibits dividend payments without prior regulatory non-objection. The memorandum of understanding also requires WDFI and Federal Deposit Insurance Corporation non-objection prior to WaterStone Bank materially changing or deviating from its strategic plan, such as material changes to funding strategies or asset mix. Waterstone Financial, Inc. remains subject to its Order issued by the Office of Thrift Supervision, through enforcement by the Federal Reserve Board, as the successor holding company regulator to the Office of Thrift Supervision.

Failure to comply with the memorandum of understanding or the holding company Order could result in additional enforcement actions by the Federal Deposit Insurance Corporation, the WDFI and the Federal Reserve Board. We have incurred significant expense in complying with the Orders, and continued compliance with the memorandum of understanding and the Order may restrict our operations or result in continued expense, either of which could have adverse effects on our operations and financial condition.

Capitalization

Wisconsin Law and Regulation. Wisconsin savings banks are required to maintain a minimum capital to assets ratio of 6% and must maintain total capital necessary to ensure the continuation of insurance of deposit accounts by the FDIC. If the WDFI determines that the financial condition, history, management or earning prospects of a savings bank are not adequate, the WDFI may require a higher minimum capital level for the savings bank. If a Wisconsin savings bank's capital ratio falls below the required level, the WDFI may direct the savings bank to adhere to a specific written plan established by the WDFI to correct the savings bank's capital deficiency, as well as a number of other restrictions on the savings bank's operations, including a prohibition on the declaration of dividends. At December 31, 2012 and 2011, WaterStone Bank's capital to assets ratio, as calculated under Wisconsin law, was 11.15% and 9.31%, respectively.

Federal Law and Regulation. Under FDIC regulations, federally insured state-chartered banks that are not members of the Federal Reserve System ("state non-member banks"), such as WaterStone Bank, are required to comply with minimum capital requirements. For an institution determined by the FDIC to not be anticipating or experiencing significant growth and to be, in general, a strong banking organization, rated composite 1 under the Uniform Financial Institutions Ranking System established by the Federal Financial Institutions Examination Council, the minimum Tier I leverage capital to total assets ratio is 3%. For all other institutions, the minimum leverage capital ratio is not less than 4%. Tier I leverage capital is the sum of common shareholders' equity, non-cumulative perpetual preferred stock (including any related surplus) and minority investments in certain subsidiaries, less intangible assets (except for certain servicing rights and credit card relationships) and certain other specified items.

The FDIC regulations require state non-member banks to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of regulatory capital to regulatory risk-weighted assets is referred to as a bank's "risk-based capital ratio." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items (including recourse obligations, direct credit substitutes and residual interests) to four risk-weighted categories generally ranging from 0% to 200%, with higher levels of capital being required for the categories perceived as representing greater risk. For example, under the Federal Deposit Insurance Corporation's risk-weighting system, cash and securities backed by the full faith and credit of the

U.S. government are given a 0% risk weight, loans secured by one-to-four family residential properties generally have a 50% risk weight, and commercial loans have a risk weighting of 100%.

State non-member banks, such as WaterStone Bank, must maintain a minimum ratio of total capital to risk-weighted assets of at least 8%, of which at least one-half must be Tier I capital. Total capital consists of Tier I capital plus Tier 2 or supplementary capital items, which include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets, cumulative preferred stock and certain other capital instruments, and a portion of the net unrealized gain on equity securities. The includable amount of Tier 2 capital cannot exceed the amount of the institution's Tier I capital. Savings banks that engage in specified levels of trading activities are subject to adjustments in their risk based capital calculation to ensure the maintenance of sufficient capital to support market risk.

The FDIC, along with the other federal banking agencies, has adopted a regulation providing that the agencies will take into account the exposure of a bank's capital and economic value to changes in interest rate risk in assessing a bank's capital adequacy. The Federal Deposit Insurance Corporation also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution's capital level is, or is likely to become, inadequate in light of the particular circumstances.

On June 6, 2012, the FDIC and the other federal bank regulatory agencies issued a series of proposed rules that would revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The proposed rules would apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more and top-tier savings and loan holding companies. Among other things, the proposed rules would establish a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and a higher minimum Tier 1 capital to risk-based assets requirement (6% of risk-weighted assets) and assign higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The proposed rules would also require unrealized gains and losses on certain securities holdings to be included for purposes of calculating regulatory capital requirements. The proposed rules would limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of a specified amount of common equity Tier 1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements. The proposed rules indicated that the final rules would become effective on January 1, 2013, and the changes set forth in the final rules would be phased in from January 1, 2013 through January 1, 2019. However, the agencies subsequently indicated that, due to the volume of public comments received, implementation of the final rule has been delayed past January 1, 2013.

Safety and Soundness Standards

Each federal banking agency, including the FDIC, has adopted guidelines establishing general standards relating to internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder.

Prompt Corrective Regulatory Action

Federal bank regulatory authorities are required to take "prompt corrective action" with respect to institutions that do not meet minimum capital requirements. For these purposes, the statute establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under the regulations, a bank shall be deemed to be (i) "well capitalized" if it has total risk-based capital of 10.0% or more, has a Tier I risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leveraged capital ratio of 4.0% or more (3.0% under certain circumstance) and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based capital ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances); (iv) "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0%; and (v) "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Federal law and regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the Federal Deposit Insurance Corporation may not reclassify a significantly undercapitalized institution as critically undercapitalized).

The Federal Deposit Insurance Corporation may order savings banks which have insufficient capital to take corrective actions. For example, a savings bank which is categorized as "undercapitalized" would be subject to growth limitations and would be required to submit a capital restoration plan, and a holding company that controls such a savings bank would be required to guarantee that the savings bank complies with the restoration plan. A "significantly undercapitalized" savings bank would be subject to additional restrictions. Savings banks deemed by the Federal Deposit Insurance Corporation to be "critically undercapitalized" would be subject to the appointment of a receiver or conservator.

The recently proposed rules that would increase regulatory capital requirements would adjust the prompt corrective action categories accordingly.

At December 31, 2012, WaterStone Bank was considered well-capitalized with a Tier 1 leverage ratio of 11.13%, a Tier 1 risk-based ratio of 16.07% and a total risk based capital ratio of 17.34%.

Dividends

Under Wisconsin law and applicable regulations, a Wisconsin savings bank that meets its regulatory capital requirement may declare dividends on capital stock based upon net profits, provided that its paid-in surplus equals its capital stock. If the paid-in surplus of the savings bank does not equal its capital stock, the board of directors may not declare a dividend unless at least 10% of the net profits of the preceding half year, in the case of quarterly or semi-annual dividends, or 10% of the net profits of the preceding year, in the case of annual dividends, has been transferred to paid-in surplus. In addition, prior WDFI approval is required before dividends exceeding 50% of profits for any calendar year may be declared and before a dividend may be declared out of retained earnings. Under WDFI regulations, a Wisconsin savings bank which has converted from mutual to stock form also is prohibited from paying a dividend on its capital stock if the payment causes the regulatory capital of the savings bank to fall below the amount required for its liquidation account.

The Federal Deposit Insurance Corporation has the authority to prohibit WaterStone Bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice in light of the financial condition of WaterStone Bank. Institutions may not pay dividends if they would be “undercapitalized” following payment of the dividend within the meaning of the prompt corrective action regulations. In addition, since WaterStone Bank is a subsidiary of a savings and loan holding company, WaterStone Bank must file a notice with the Federal Reserve Board at least 30 days before the board declares a dividend or approves a capital distribution.

A memorandum of understanding we have entered into with the Federal Deposit Insurance Corporation and the WDFI prohibits WaterStone Bank from making dividend payments without prior written regulatory approval.

Liquidity and Reserves

Wisconsin Law and Regulation. Under WDFI regulations, all Wisconsin savings banks are required to maintain a certain amount of their assets as liquid assets, consisting of cash and certain types of investments. The exact amount of assets a savings bank is required to maintain as liquid assets is set by the WDFI, but generally ranges from 4% to 15% of the saving bank’s average daily balance of net withdrawable accounts plus short-term borrowings (the “Required Liquidity Ratio”). At December 31, 2012, WaterStone Bank’s Required Liquidity Ratio was 8.0%, and WaterStone Bank was in compliance with this requirement. In addition, 50% of the liquid assets maintained by Wisconsin savings banks must consist of “primary liquid assets,” which are defined to include securities issued by the United States government and United States government agencies. At December 31, 2012, WaterStone Bank was in compliance with this requirement.

Federal Law and Regulation. Under federal law and regulations, WaterStone Bank is required to maintain sufficient liquidity to ensure safe and sound banking practices. Regulation D, promulgated by the Federal Reserve Board, imposes reserve requirements on all depository institutions, including WaterStone Bank, which maintain transaction accounts or non-personal time deposits. Checking accounts, NOW accounts, Super NOW checking accounts, and certain other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to Regulation D reserve requirements, as are any non-personal time deposits (including certain money market deposit accounts) at a savings institution. For 2013, a depository institution is required to maintain average daily reserves equal to 3% on the first $79.5 million of transaction accounts and an initial reserve of $1.4 million, plus 10% of that portion of total transaction accounts in excess of $79.5 million. The first $12.4 million of otherwise reservable balances (subject to adjustment by the Federal Reserve Board) are exempt from the reserve requirements. These percentages and threshold limits are subject to adjustment by the Federal Reserve Board. Savings institutions have authority to borrow from the Federal Reserve's "discount window," but Federal Reserve policy generally requires savings institutions to exhaust all other sources before borrowing from the Federal Reserve. As of December 31, 2012, WaterStone Bank met its Regulation D reserve requirements.

Transactions with Affiliates and Insiders

Wisconsin Law and Regulation. Under Wisconsin law, WaterStone Bank may not make a loan to a person owning 10% or more of its stock, an affiliated person, agent, or attorney of the savings bank, either individually or as an agent or partner of another, except as approved by the WDFI and regulations of the FDIC. In addition, unless the prior approval of the WDFI is obtained, WaterStone Bank may not purchase, lease or acquire a site for an office building or an interest in real estate from an affiliated person, including a shareholder owning more than 10% of its capital stock, or from any firm, corporation, entity or family in which an affiliated person or 10% shareholder has a direct or indirect interest.

Federal Law and Regulation. Sections 23A and 23B of the Federal Reserve Act govern transactions between an insured savings bank, such as WaterStone Bank, and any of its affiliates, including Waterstone Financial. The Federal Reserve Board has adopted Regulation W, which comprehensively implements and interprets Sections 23A and 23B, in part by codifying prior Federal Reserve Board interpretations under Sections 23A and 23B.

An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. A subsidiary of a bank that is not also a depository institution or a "financial subsidiary" under federal law is not treated as an affiliate of the bank for the purposes of Sections 23A and 23B; however, the FDIC has the discretion to treat subsidiaries of a bank as affiliates on a case-by-case basis. Sections 23A and 23B limit the extent to which a bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such bank's capital stock and surplus, and limit all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The statutory sections also require that all such transactions be on terms that are consistent with safe and sound banking practices. The term "covered transaction" includes the making of loans, purchase of assets, issuance of guarantees and other similar types of transactions. Further, most loans and other extensions of credit by a bank to any of its affiliates must be secured by collateral in amounts ranging from 100% to 130% of the loan amounts. In addition, any covered transaction by an association with an affiliate and any purchase of assets or services by an association from an affiliate must be on terms that are substantially the same, or at least as favorable, to the bank as those that would be provided to a non-affiliate.

A savings bank's loans to its executive officers, directors, any owner of more than 10% of its stock (each, an insider) and any of certain entities affiliated with any such person (an insider's related interest) are subject to the conditions and limitations imposed by Section 22(h) of the Federal Reserve Act and the FRB's Regulation O thereunder. Under these restrictions, the aggregate amount of the loans to any insider and the insider's related interests may not exceed the loans-to-one-borrower limit applicable to national banks, which is comparable to the loans-to-one-borrower limit applicable to WaterStone Bank's loans. All loans by a savings bank to all insiders and insiders' related interests in the aggregate may not exceed the bank's unimpaired capital and unimpaired surplus. With certain exceptions, loans to an executive officer, other than loans for the education of the officer's children and certain loans secured by the officer's residence, may not exceed the greater of $25,000 or 2.5% of the savings bank's unimpaired capital and unimpaired surplus, but in no event more than $100,000. Regulation O also requires that any proposed loan to an insider or a related interest of that insider be approved in advance by a majority of the board of directors of the savings bank, with any interested director not participating in the voting, if such loan, when aggregated with any existing loans to that insider and the insider's related interests, would exceed either $500,000 or the greater of $25,000 or 5% of the savings bank's unimpaired capital and surplus. Generally, such loans must be made on substantially the same terms as, and follow credit underwriting procedures that are no less stringent than, those that are prevailing at the time for comparable transactions with other persons and must not present more than a normal risk of collectibility.

An exception to this requirement is made for extensions of credit made pursuant to a benefit or compensation plan of a bank that is widely available to employees of the savings bank and that does not give any preference to insiders of the bank over other employees of the bank. Consistent with these requirements, the Bank offered employees special terms for home mortgage loans on their principal residences. Effective April 1, 2006, this program was discontinued for new loan originations. Under the terms of the discontinued program, the employee interest rate is based on the Bank's cost of funds on December 31st of the immediately preceding year and is adjusted annually. At December 31, 2012, the rate of interest on an employee rate mortgage loan was 2.06%, compared to the weighted average rate of 5.07% on all single family mortgage loans. This rate decreased to 1.68% effective March 1, 2013. Employee rate mortgage loans totaled $3.3 million, or 0.3%, of our residential mortgage loan portfolio on December 31, 2012.

Transactions between Bank Customers and Affiliates

Under Wisconsin and federal laws and regulations, Wisconsin savings banks, such as WaterStone Bank, are subject to the prohibitions on certain tying arrangements. A savings bank is prohibited, subject to certain exceptions, from extending credit to or offering any other service to a customer, or fixing or varying the consideration for such extension of credit or service, on the condition that such customer obtain some additional service from the institution or certain of its affiliates or not obtain services of a competitor of the institution.

Examinations and Assessments

WaterStone Bank is required to file periodic reports with and is subject to periodic examinations by the WDFI and FDIC. Federal regulations require annual on-site examinations for all depository institutions except certain well-capitalized and highly rated institutions with assets of less than $500 million which are examined every 18 months. WaterStone Bank is required to pay examination fees and annual assessments to fund its supervision. WaterStone Bank paid an aggregate of $88,000 in assessments for the calendar year ended December 31, 2012.

Customer Privacy

Under Wisconsin and federal law and regulations, savings banks, such as WaterStone Bank, are required to develop and maintain privacy policies relating to information on its customers, restrict access to and establish procedures to protect customer data. Applicable privacy regulations further restrict the sharing of non-public customer data with non-affiliated parties if the customer requests.

Community Reinvestment Act

Under the Community Reinvestment Act ("CRA"), WaterStone Bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the Federal Deposit Insurance Corporation in connection with its examination of WaterStone Bank, to assess its record of meeting the credit needs of its community and to take that record into account in its evaluation of certain applications by WaterStone Bank. For example, the regulations specify that a bank's CRA performance will be considered in its expansion (e.g., branching) proposals and may be the basis for approving, denying or conditioning the approval of an application. As of the date of its most recent regulatory examination, WaterStone Bank was rated "satisfactory" with respect to its CRA compliance.

Federal Home Loan Bank System

The Federal Home Loan Bank System, consisting of twelve FHLBs, is under the jurisdiction of the Federal Housing Finance Board ("FHFB"). The designated duties of the FHFB are to supervise the FHLBs; ensure that the FHLBs carry out their housing finance mission; ensure that the FHLBs remain adequately capitalized and able to raise funds in the capital markets; and ensure that the FHLBs operate in a safe and sound manner.

WaterStone Bank, as a member of the FHLB of Chicago, is required to acquire and hold shares of capital stock in the FHLB of Chicago in specified amounts. WaterStone Bank is in compliance with this requirement with an investment in FHLB of Chicago stock of $20.2 million at December 31, 2012.

Among other benefits, the FHLBs provide a central credit facility primarily for member institutions. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes advances to members in accordance with policies and procedures established by the FHFB and the board of directors of the FHLB of Chicago. At December 31, 2012, WaterStone Bank had $350.0 million in advances from the FHLB of Chicago.

USA PATRIOT Act

The USA PATRIOT Act of 2001 gave the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The USA PATRIOT Act also required the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if we engage in a merger or other acquisition, our controls designed to combat money laundering would be considered as part of the application process. We have established policies, procedures and systems designed to comply with these regulations.

Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") is making extensive changes in the regulation of insured depository institution. Under the Dodd-Frank Act, the Office of Thrift Supervision was eliminated as of July 21, 2011. Responsibility for the supervision and regulation of federal savings banks was transferred to the Office of the Comptroller of the Currency, which is the agency that is currently primarily responsible for the regulation and supervision of national banks. At the same time, responsibility for the regulation and supervision of savings and loan holding companies, such as Lamplighter Financial and Waterstone Financial, was transferred to the Federal Reserve Board, which also supervises bank holding companies.

Additionally, the Dodd-Frank Act created a new Consumer Financial Protection Bureau as an independent bureau of the Federal Reserve Board. The Consumer Financial Protection Bureau has assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations, a function previously assigned to prudential regulators, and has authority to impose new requirements. Institutions of less than $10 billion in assets, however, such as WaterStone Bank, will continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the primary enforcement authority of, their prudential regulators rather than the Consumer Financial Protection Bureau.

In addition to eliminating the Office of Thrift Supervision and creating the Consumer Financial Protection Bureau, the Dodd-Frank Act, among other things, directed changes in the way that institutions are assessed for deposit insurance, mandated the imposition of consolidated capital requirements on savings and loan holding companies, required originators of securitized loans to retain a percentage of the risk for the transferred loans, provided for regulatory rate-setting for certain debit card interchange fees, repealed restrictions on the payment of interest on commercial demand deposits and contained a number of reforms related to mortgage originations. Many of the provisions of the Dodd-Frank Act are subject to delayed effective dates and/or require the issuance of implementing regulations. Their impact on operations can not yet be fully assessed. However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden, compliance costs and interest expense for Waterstone Bank, Lamplighter Financial and Waterstone Financial.

Regulation of Waterstone Financial

Holding Company Regulation

Wisconsin Law and Regulation. Any company that owns or controls, directly or indirectly, more than 25% of the voting securities of a state savings bank is subject to regulation as a savings bank holding company by the WDFI. Waterstone Financial and Lamplighter Financial, MHC are subject to regulation as savings bank holding companies under Wisconsin law. However, the WDFI has not issued specific regulations governing savings bank holding companies.

Federal Law and Regulation. Lamplighter Financial and Waterstone Financial are savings and loan holding companies within the meaning of the Home Owners' Loan Act. They are registered with and regulated by the Federal Reserve Board. The Federal Reserve Board succeeded the Office of Thrift Supervision as federal regulator of savings and loan holding companies in July 2011. Pursuant to applicable laws, regulations, and policies, a mutual holding company, such as Lamplighter Financial, MHC and a federally chartered mid-tier holding company, such as Waterstone Financial may engage in the following activities: (i) investing in the stock of a savings bank, (ii) acquiring a mutual savings bank through the merger of such savings bank into a savings bank subsidiary of such holding company or an interim savings bank subsidiary of such holding company, (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings bank, (iv) investing in a corporation, the capital stock of which is available for purchase by a savings bank under federal law or under the law of any state where the subsidiary savings bank or savings banks share their home offices, (v) furnishing or performing management services for a savings bank subsidiary of such company, (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company, (vii) holding or managing properties used or occupied by a savings bank subsidiary of such company, (viii) acting as trustee under deeds of trust, (ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Director, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987, (x) any activity permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act, including securities and insurance underwriting, and (xi) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the Federal Reserve Board. If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed in (i) through (xi) above, and has a period of two years to cease any nonconforming activities and divest of any nonconforming investments.

The Home Owners' Loan Act prohibits a savings and loan holding company, including Waterstone Financial and Lamplighter Financial, MHC, directly or indirectly, or through one or more subsidiaries, from acquiring more than 5% of another savings institution or holding company thereof, without prior written approval of the Federal Reserve Board. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a non-subsidiary company engaged in activities other than those permitted by the Home Owners' Loan Act; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider factors such as the financial and managerial resources, future prospects of the company and institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

The Federal Reserve Board is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions.

Savings and loan holding companies historically have not been subject to consolidated regulatory capital requirements. However, the Dodd-Frank Act requires the Federal Reserve Board to set for all depository institution holding companies minimum consolidated capital levels that are as stringent as those required for the insured depository subsidiaries. The components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions, which would exclude instruments such as trust preferred securities and cumulative preferred stock. Instruments issued before May 19, 2010 are grandfathered for companies with consolidated assets of $15 billion or less. Holding companies that were not regulated by the Federal Reserve Board as of May 19, 2010 receive a five year phase-in from the July 21, 2010 date of enactment of the Dodd-Frank Act. The proposed capital rules discussed above would implement the consolidated capital requirements for savings and loan holding companies. However, the proposed rules did not incorporate the grandfather included in the Dodd-Frank Act for instruments issued before May 19, 2010, or the five-year transition period, and it is uncertain whether any final rule will do so.

The Dodd-Frank Act extended the “source of strength” doctrine to savings and loan holding companies. The regulatory agencies must promulgate regulations implementing the “source of strength” policy that requires holding companies to act as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

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

Waivers of Dividends by Lamplighter Financial, MHC

The Dodd-Frank Act requires federally-chartered mutual holding companies to give the Federal Reserve Board notice before waiving the receipt of dividends, and provides that in the case of "grandfathered" mutual holding companies, the Federal Reserve Board "may not object" to a dividend waiver if the board of directors of the mutual holding company waiving dividends determines that the waiver: (i) would not be detrimental to the safe and sound operation of the subsidiary savings bank; and (ii) is consistent with the board's fiduciary duties to members of the mutual holding company. To qualify as a grandfathered mutual holding company, a mutual holding company must have been formed, issued stock and waived dividends prior to December 1, 2009. In September 2011, however, the Federal Reserve Board issued an interim final rule that also requires, as a condition to waiving dividends, that each mutual holding company obtain the approval of a majority of the eligible votes of its members within 12 months prior to the declaration of the dividend being waived. Lamplighter Financial, MHC does not qualify as a grandfathered mutual holding company. Non-grandfathered mutual holding companies are subject to additional requirements under the interim final rule, such as having directors of the mutual holding company who own stock in the subsidiary holding company to abstain from voting on the dividend waiver or waive the receipt of dividends themselves. These additional restrictions would effectively prevent Lamplighter Financial, MHC from waiving any dividends declared by Waterstone Financial, Inc.. As a result, it is not expected that Lamplighter Financial, MHC will waive any dividends declared by Waterstone Financial, Inc. in the future unless the Federal Reserve Board eliminates certain restrictions and requirements contained in the interim rule. Moreover, as previously noted, an existing regulatory memorandum of understanding currently prohibits the payment of dividends by WaterStone Financial without prior regulatory consent.

Conversion of Lamplighter Financial, MHC to Stock Form

Federal Reserve Board regulations permit Lamplighter Financial, MHC to convert from the mutual form of organization to the capital stock form of organization (a "Conversion Transaction"). There can be no assurance when, if ever, a Conversion Transaction will occur. In a Conversion Transaction a new holding company would be formed as the successor to Waterstone Financial (the "New Holding Company"), Lamplighter Financial, MHC's corporate existence would end, and certain depositors of WaterStone Bank would receive the right to subscribe for shares of the New Holding Company. In a Conversion Transaction, each share of common stock held by shareholders other than Lamplighter Financial, MHC ("Minority Shareholders") would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant to an exchange ratio that ensures that Minority Shareholders own the same percentage of common stock in the New Holding Company as they owned in Waterstone Financial immediately prior to the Conversion Transaction subject to adjustment for any mutual holding company assets or waived dividends, as applicable. The total number of shares of common stock held by Minority Shareholders after a Conversion Transaction also would be increased by any purchases by Minority Shareholders in the stock offering conducted as part of the Conversion Transaction.

Any Conversion Transaction would require the approval of a majority of the outstanding shares of common stock of Waterstone Financial held by Minority Shareholders and by two-thirds of the total outstanding shares of common stock of Waterstone Financial. Any Conversion Transaction also would require the approval of a majority of the eligible votes of depositors of Lamplighter Financial, MHC.

Federal Securities Laws Regulation

Securities Exchange Act. Waterstone Financial common stock is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934. The Company is therefore subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 was adopted in response to public concerns regarding corporate accountability and oversight. The Sarbanes-Oxley Act is intended to improve corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

Federal and State Taxation

Federal Taxation

General. Waterstone Financial and subsidiaries and Lamplighter Financial, MHC are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. Waterstone Financial and subsidiaries constitute an affiliated group of corporations and, therefore, are eligible to report their income on a consolidated basis. Because Lamplighter Financial, MHC owns less than 80% of the common stock of Waterstone Financial, it is not a member of that affiliated group and will report its income on a separate return. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Lamplighter Financial, MHC, Waterstone Financial or WaterStone Bank.

Method of Accounting. For federal income tax purposes, Waterstone Financial currently reports its income and expenses on the accrual method of accounting and uses a tax year ending December 31 for filing its federal income tax returns.

Bad Debt Reserves. Prior to the Small Business Protection Act of 1996 (the "1996 Act"), WaterStone Bank was permitted to establish a reserve for bad debts and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at our taxable income. As a result of the 1996 Act, WaterStone Bank was required to use the specific charge-off method in computing its bad debt deduction beginning with its 1996 federal tax return. Savings institutions were required to recapture any excess reserves over those established as of December 31, 1987 (base year reserve). At December 31, 2012, WaterStone Bank had no reserves subject to recapture in excess of its base year.

Taxable Distributions and Recapture. Prior to the 1996 Act, bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income if WaterStone Bank failed to meet certain thrift asset and definitional tests. Federal legislation has eliminated these thrift-related recapture rules. At December 31, 2012, our total federal pre-1988 base year reserve was approximately $16.7 million. However, under current law, pre-1988 base year reserves remain subject to recapture if WaterStone Bank makes certain non-dividend distributions, repurchases any of its stock, pays dividends in excess of tax earnings and profits, or ceases to maintain a bank charter.

Alternative Minimum Tax. The Internal Revenue Code of 1986, as amended (the "Code"), imposes an alternative minimum tax ("AMT") at a rate of 20% on a base of regular taxable income plus certain tax preferences which we refer to as "alternative minimum taxable income." The AMT is payable to the extent such alternative minimum taxable income is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses can offset no more than 90% of alternative minimum taxable income. AMT payments may be used as credits against regular tax liabilities in future years. Due to a federal net operating loss carry back generated in 2008, Waterstone Financial became subject to AMT for 2006 and 2007. At December 31, 2012, the Company had no such amounts available as credits for carryover.

Net Operating Loss Carryovers. A company may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. A 2009 federal tax law change allows for a one-time carry back of either 2008 or 2009 taxable losses for up to five years. The Company had a Federal net operating loss carry forward of $3.0 million at December 31, 2011 that was fully utilized during the year ended December 31, 2012.

Corporate Dividends-Received Deduction. Waterstone Financial may exclude from its income 100% of dividends received from WaterStone Bank as a member of the same affiliated group of corporations. The corporate dividends-received deduction is 80% in the case of dividends received from corporations with which a corporate recipient does not file a consolidated tax return, and corporations that own less than 20% of the stock of a corporation distributing a dividend may deduct only 70% of dividends received or accrued on their behalf.

State Taxation

Wisconsin State Taxation. Lamplighter Financial, MHC and the Company are subject to the Wisconsin corporate franchise (income) tax. Under current law, the state of Wisconsin imposes a corporate franchise tax of 7.9% on the combined taxable incomes of the members of our consolidated income tax group. Prior to January 1, 2009, the income of the Nevada subsidiary was only subject to taxation in Nevada, which currently does not impose a corporate income or franchise tax. In February 2009, the Wisconsin legislature passed legislation that requires combined state tax reporting effective January 1, 2009. This legislation results in the apportioned income of the Nevada subsidiary being subject to the Wisconsin corporate franchise tax of 7.9%.

Item 1A. Risk Factors

Waterstone Financial, Inc. operates under a consent order and WaterStone Bank operates under a memorandum of understanding. The consent order and the memorandum of understanding restrict our operations, and the failure to comply with either could result in additional enforcement actions by the Federal Reserve Board, the Federal Deposit Insurance Corporation or the WDFI. Continued compliance with the memorandum of understanding and the consent order may also have adverse effects on our operations and financial condition.

On November 25, 2009, pursuant to a Stipulation and Consent to the Issuance of a Consent Order, WaterStone Bank agreed to the issuance of a Consent Order jointly issued by the Federal Deposit Insurance Corporation and the WDFI, WaterStone Bank's primary banking regulators. At the same time, pursuant to a Stipulation and Consent to Issuance of Order to Cease and Desist, Waterstone Financial, Inc. agreed to the issuance of an Order to Cease and Desist by the Office of Thrift Supervision, Waterstone Financial, Inc's holding company regulator at the time. Collectively, the Stipulation and Consent to the Issuance of a Consent Order which became effective on December 18, 2009 and the Stipulation and Consent to Issuance of Order to Cease and Desist which became effective on December 1, 2009; are referred to as the "Orders".

The Order issued by the Office of Thrift Supervision requires, among other things, that Waterstone Financial, Inc adopt a two year capital plan that included plans for WaterStone Bank to maintain minimum Tier 1 capital of 8.5% of total average assets and minimum total risk-based capital of 12.0% of risk-weighted assets. The Order issued by the Office of Thrift Supervision also prohibited the payment of cash dividends or repurchases of common stock, and restricted the ability of Waterstone Financial, Inc to incur debt, in each case without prior regulatory non-objection.

Effective December 11, 2012, the WDFI and the Federal Deposit Insurance Corporation terminated the Order issued to WaterStone Bank. The terminated Order was replaced with a memorandum of understanding that requires, among other things, maintenance of a minimum Tier I capital ratio of 8.0% and a minimum total risk based capital ratio of 12.0%, and also prohibits dividend payments without prior regulatory non-objection. The memorandum of understanding also requires WDFI and Federal Deposit Insurance Corporation non-objection prior to WaterStone Bank materially changing or deviating from its strategic plan, such as material changes to funding strategies or asset mix. Waterstone Financial, Inc remains subject to its Order issued by the Office of Thrift Supervision, through enforcement by the Federal Reserve Board, as the successor holding company regulator to the Office of Thrift Supervision.

Failure to comply with the memorandum of understanding or the holding company Order could result in additional enforcement actions by the Federal Deposit Insurance Corporation, the WDFI and the Federal Reserve Board. We have incurred significant expense in complying with the Orders, and continued compliance with the memorandum of understanding and the Order may restrict our operations or result in continued expense, either of which could have adverse effects on our operations and financial condition.

Changing interest rates may have a negative effect on our results of operations.

Our earnings and cash flows are largely dependent on our net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Any substantial, unexpected or prolonged change in market interest rates could have an adverse effect on our financial condition and results of operations. Our interest-bearing liabilities generally reprice or mature more quickly than our interest-earning assets. If rates increase rapidly, we may have to increase the rates we pay on our deposits, particularly our higher cost time deposits, and borrowed funds more quickly than any changes in interest rates earned on our loans and investments, resulting in a negative effect on interest spreads and net interest income. Furthermore, our mortgage banking income varies directly with movements in interest rates, and increases in interest rates could negatively affect our ability to originate loans in the same quantities as we have in recent years. Increases in interest rates may also make it more difficult for borrowers to repay adjustable rate loans.

Conversely, should market interest rates fall below current levels, our net interest margin could also be negatively affected if competitive pressures keep us from further reducing rates on our deposits, while the yields on our assets decrease more rapidly through loan prepayments and interest rate adjustments. Decreases in interest rates often result in increased prepayments of loans and mortgage-related securities, as borrowers refinance their loans to reduce borrowings costs. Under these circumstances, we are subject to reinvestment risk to the extent we are unable to reinvest the cash received from such prepayments in loans or other investments that have interest rates that are comparable to the interest rates on existing loans and securities.

We also are subject to reinvestment risk associated with changes in interest rates. Changes in interest rates may affect the average life of loans and mortgage-related securities. Decreases in interest rates often result in increased prepayments of loans and mortgage-related securities, as borrowers refinance their loans to reduce borrowings costs. Under these circumstances, we are subject to reinvestment risk to the extent we are unable to reinvest the cash received from such prepayments in loans or other investments that have interest rates that are comparable to the interest rates on existing loans and securities.

At December 31, 2012, our simulation model indicated that our annual net interest income would decrease by 0.78% if there was a gradual 100 basis point increase in market interest rates. See Item 7A. "Quantitative and Qualitative Disclosures about Market Risk."

During 2012 we continued to experience high levels of delinquencies, non-accrual loans and charge-offs.

During 2012, we continued to experience high levels of non-accrual loans and loan delinquencies. Our non-accrual loans totaled $74.7 million, or 6.59% of total loans at December 31, 2012, compared to $78.2 million, or 6.43% of total loans at December 31, 2011. Our loans past due totaled $74.4 million, or 6.6% of total loans receivable at December 31, 2012, compared to $93.4 million, or 7.7% of total loans at December 31, 2011. While loan charge-offs have decreased compared to the prior year, the continued high level of non-performing and delinquent loans has resulted in elevated levels of loan charge-offs as compared to historical averages. During 2012, net charge-offs totaled $9.7 million. Our high level of problem assets has also increased our costs associated with monitoring delinquent loans and disposing of foreclosed property. To the extent that our loan portfolio deteriorates, our financial condition and results of operations will be materially and adversely affected. Continued deterioration could also lead to additional actions by regulators that could have a direct material effect on our financial condition and results of operation.

We rely heavily on certificates of deposit, which has increased our cost of funds and could continue to do so in the future.

At December 31, 2012, certificates of deposit comprised 78.4% of our total deposits. Our reliance on certificates of deposit to fund our operations has resulted in a higher cost of funds than would otherwise be the case if we had a higher percentage of demand deposits, savings and money market accounts. In addition, if our certificates of deposit do not remain with us, we may be required to seek other sources of funds, including loan sales, other deposit products, including replacement certificates of deposit, securities sold under agreements to repurchase and advances from the Federal Home Loan Bank of Chicago and other borrowing sources. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on our certificates of deposit.

We operate in a highly regulated environment and we are subject to supervision, examination and enforcement action by various regulatory agencies.

We are subject to extensive supervision, regulation, and examination by the WDFI, the Federal Deposit Insurance Corporation and the Federal Reserve Board. As a result, we are limited in the manner in which we conduct our business, undertake new investments and activities, and obtain financing. This regulatory structure is designed primarily for the protection of the Deposit Insurance Fund and our depositors, and not to benefit our stockholders. This regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement actions and examination policies, including policies with respect to capital levels, the timing and amount of dividend payments, the classification of assets, the establishment of adequate loan loss reserves for regulatory purposes and the timing and amounts of assessments and fees.

In addition, we must comply with significant anti-money laundering and anti-terrorism laws and regulations, Community Reinvestment Act laws and regulations, and fair lending laws and regulations. Government agencies have the authority to impose monetary penalties and other sanctions on institutions that fail to comply with these laws and regulations, which could significantly affect our business activities, including our ability to acquire other financial institutions or expand our branch network.

We have been negatively affected by current market and economic conditions. A continuation or worsening of these conditions could adversely affect our operations, financial condition, and earnings.

We are operating in a difficult and uncertain economic environment characterized by high unemployment rates, a weak real estate market and a weak economy. The resulting economic pressure on consumers and businesses has adversely affected our business, financial condition, and results of operations. Financial companies' stock prices have been negatively affected, as has the ability of banks and bank holding companies to raise capital or borrow in the debt markets. The recent economic recession and contraction of the local and national real estate markets have also resulted in elevated levels of provisions for loan losses, loan charge-offs and losses related to the write down of real estate owned in recent years, and a continuation or worsening of these conditions may also cause further valuation changes and losses in our loan and investment portfolios as well as reduction in the estimated realizable value of real estate owned and increased costs associated with monitoring delinquent loans and disposing of foreclosed property. These conditions have negatively affected our earnings, capital levels and regulatory capital ratios and may continue to do so in future periods.

If our allowance for loan losses is not sufficient to cover actual loan losses, our results of operations would be negatively affected.

In determining the amount of the allowance for loan losses, we analyze our loss and delinquency experience by loan categories and we consider the effect of existing economic conditions. In addition, we make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. If the results of our analyses are incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, which would require additions to our allowance and would decrease our net income. Our emphasis on loan growth and on increasing our portfolio of commercial real estate loans, as well any future credit deterioration, could require us to increase our allowance further in the future.

In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities may have a material adverse effect on our results of operations and financial condition.

Deterioration of our investment portfolio could have a negative impact on our results of operations.

The recent economic downturn has resulted in other-than-temporary impairment of securities in our overall investment portfolio, including a decline in value of mortgage related securities, which are dependent upon the performance of the underlying mortgages that provide the principal and interest cash flow for the securities. During the years ended December 31, 2012 and 2011, we recognized total other-than-temporary impairment on our securities portfolio of $190,000 and $1.5 million, respectively, of which $213,000 and $456,000, respectively, were considered to be credit-related and, therefore, recorded as a loss through a reduction of non-interest income. Similarly, growing state and municipality budget deficits resulting from declining tax revenues may result in related declines in the value of debt securities they have issued in prior years. Continued weakness or deterioration in general economic market conditions could result in future impairment losses on these securities or other investment securities.

Changes in the structure of Fannie Mae and Freddie Mac ("GSEs") and the relationship among the GSEs, the federal government and the private markets, or the conversion of the current conservatorship of the GSEs into receivership, could result in significant changes to our securities portfolio.

The GSEs are currently in conservatorship, with its primary regulator, the Federal Housing Finance Agency, acting as conservator. We cannot predict if, when or how the conservatorships will end, or any associated changes to the GSEs' business structure that could result. We also cannot predict whether the conservatorships will end in receivership. There are several proposed approaches to reform the GSEs which, if enacted, could change the structure of the GSEs and the relationship among the GSEs, the government and the private markets, including the trading markets for agency conforming mortgage loans and markets for mortgage-related securities in which we participate. We cannot predict the prospects for the enactment, timing or content of legislative or rulemaking proposals regarding the future status of the GSEs. Accordingly, there continues to be uncertainty regarding the future of the GSEs, including whether they will continue to exist in their current form. GSE reform, if enacted, could result in significant changes and adversely affect our business operations.

An increase in interest rates may reduce our mortgage banking revenues, which would negatively impact our non-interest income.

Our mortgage banking operations provide a significant portion of our interest and non-interest income. We generate mortgage revenues primarily from gains on the sale of mortgage loans to investors. We also earn interest on loans held for sale while they are awaiting delivery to our investors. In a rising or higher interest rate environment, our originations of mortgage loans may decrease, resulting in fewer loans that are available to be sold to investors. This would result in a decrease in interest income, a decrease in mortgage revenues and a corresponding decrease in non-interest income. In addition, our results of operations are affected by the amount of non-interest expenses associated with mortgage banking activities, such as salaries and employee benefits, occupancy, equipment and data processing expense and other operating costs. During periods of reduced loan demand, our results of operations may be adversely affected to the extent that we are unable to reduce expenses commensurate with the decline in mortgage loan origination activity.

Secondary mortgage market conditions could have a material impact on our financial condition and results of operations.

In addition to being affected by interest rates, the secondary mortgage markets are also subject to investor demand for residential mortgage loans and increased investor yield requirements for those loans. These conditions may fluctuate or even worsen in the future. In light of current conditions, there is a higher risk to retaining a larger portion of mortgage loans than we would in other environments until they are sold to investors. We believe our ability to retain fixed-rate residential mortgage loans is limited. As a result, a prolonged period of secondary market illiquidity may reduce our loan production volumes and could have a material adverse effect on our financial condition and results of operation.

If we are required to repurchase mortgage loans that we have previously sold, it would negatively affect our earnings.

One of our primary business operations is our mortgage banking operations, under which we sell residential mortgage loans in the secondary market under agreements that contain representations and warranties related to, among other things, the origination and characteristics of the mortgage loans. We may be required to repurchase mortgage loans that we have sold in cases of borrower default or breaches of these representations and warranties. If we are required to repurchase mortgage loans or provide indemnification or other recourse, this could significantly increase our costs and thereby affect our future earnings.

Our non-interest expense will continue to be negatively affected by increases in Federal Deposit Insurance Corporation insurance premiums.

The Federal Deposit Insurance Corporation assesses premiums for deposit insurance on insured banks and savings banks. This assessment is based on the risk category of the institution, and certain specified adjustments, and currently ranges from 2.5 to 45 basis points of the institution's total assets less tangible capital. Federal law requires that the Federal Deposit Insurance Corporation takes steps as are necessary to achieve a Deposit Insurance Fund reserve ratio of 1.35% of insured deposits of September 30, 2020. The Federal Deposit Insurance Corporation has established a longer term designated reserve ratio of 2%.

Due to stress on the Deposit Insurance Fund caused by numerous bank failures, the Federal Deposit Insurance Corporation imposed a maximum 10 basis point of insured deposits special assessment that was collected on September 30, 2009. On November 12, 2009, the Federal Deposit Insurance Corporation issued a rule pursuant to which all insured depository institutions were required to prepay their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. The prepayment was due on December 31, 2009. Under the rule, the assessment rate for the fourth quarter of 2009 and for 2010 was based on each institution's total base assessment rate for the third quarter of 2009, modified to assume that the assessment rate in effect on September 30, 2009 had been in effect for the entire third quarter, and the assessment rate for 2011 and 2012 was equal to the modified third quarter assessment rate plus an additional three basis points. In addition, each institution's base assessment rate for each period was calculated using its third quarter assessment base, adjusted quarterly for an estimated 5% annual growth rate in the assessment base through the end of 2012. WaterStone Bank received a waiver from the Federal Deposit Insurance Corporation with respect to the 2010, 2011 and 2012 insurance prepayment.

Increased assessments significantly increased our non-interest expense for those years and may increase non-interest expense in future years when the Federal Deposit Insurance Corporation's designated reserve ratio is low.

Because most of our borrowers are located in the Milwaukee, Wisconsin metropolitan area, a prolonged downturn in the local economy, or a decline in local real estate values, could cause an increase in nonperforming loans or a decrease in loan demand, which would reduce our profits.

Substantially all of our loans are secured by real estate located in our primary market area. Continued weakness in our local economy and our local real estate markets could adversely affect the ability of our borrowers to repay their loans and the value of the collateral securing our loans, which could adversely affect our results of operations. Real estate values are affected by various factors, including supply and demand, changes in general or regional economic conditions, interest rates, governmental rules or policies, natural disasters, and the threat of terrorist attacks. Continued weakness in economic conditions also could result in reduced loan demand and a decline in loan originations. In particular, a significant decline in real estate values would likely lead to a decrease in new loan originations and increased delinquencies and defaults in our real estate loan portfolio.

Strong competition within our market areas may limit our growth and profitability.

Competition in the banking and financial services industry is intense. In our market areas, we compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, money market funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Some of our competitors have greater name recognition and market presence and offer certain services that we do not or cannot provide, all of which benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively than we do.

Financial reform legislation is expected to increase our costs of operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), has significantly changed the bank regulatory structure and affected the lending, investment, trading and operating activities of depository institutions and their holding companies. The Dodd-Frank Act authorized the Federal Reserve Board to supervise and regulate all savings and loan holding companies; like Waterstone Financial and Lamplighter Financial, Inc., in addition to bank holding companies. The Dodd-Frank Act also instructed the Federal Reserve Board to set minimum capital levels for holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Savings and loan holding companies are subject to a five year transition period before the holding company capital requirement will apply.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as the Bank, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets will be examined by their applicable bank regulators.

The legislation broadened the base for Federal Deposit Insurance Corporation insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008, and non-interest bearing transaction accounts have unlimited deposit insurance through December 31, 2012. Further, the legislation removed restrictions on the payment of interest on commercial demand deposits, mandated that regulators issue regulations requiring originators of securitized loans to retain a percentage of the risk for transferred loans, directed the Federal Reserve Board to regulate pricing of certain debit card interchange fees and requires other reforms related to mortgage loan originators.

It is difficult to predict at this time the effect that the legislation and implementing regulations will have on community banks with regard to lending and credit practices. Many of the provisions of the Dodd-Frank Act have delayed effective dates, and the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of all of these regulations cannot be determined at this time, it is expected that the legislation and implementing regulations, particularly those relating to the new Consumer Financial Protection Bureau, will increase our operating and compliance costs.

Changes in our accounting policies or in accounting standards could materially affect how we report our financial condition and results of operations.

Our accounting policies are essential to understanding our financial results and condition. Some of these policies require the use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Some of our accounting policies are critical because they require management to make difficult, subjective, and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. If such estimates or assumptions underlying our financial statements are incorrect, we may experience material losses.

From time to time, the Financial Accounting Standards Board and the Securities and Exchange Commission change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of our financial statements. These changes are beyond our control, can be hard to predict and could materially affect how we report our results of operations and financial condition. We could also be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements in material amounts.

The need to account for certain assets at estimated fair value may adversely affect our results of operations.

We report certain assets, such as loans held for sale, at estimated fair value. Generally, for assets that are reported at fair value, we use quoted market prices or valuation models that utilize observable market inputs to estimate fair value. Because we carry these assets on our books at their estimated fair value, we may incur losses even if the asset in question presents minimal credit risk.

Because the nature of the financial services business involves a high volume of transactions, we face significant operational risks.

We operate in diverse markets and rely on the ability of our employees and systems to process a high number of transactions. Operational risk is the risk of loss resulting from our operations, including but not limited to, the risk of fraud by employees or persons outside our company, the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, breaches of the internal control system and compliance requirements, and business continuation and disaster recovery. Insurance coverage may not be available for such losses, or where available, such losses may exceed insurance limits. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, we could suffer financial loss, face regulatory action, and suffer damage to our reputation.

Risks associated with system failures, interruptions, or breaches of security could negatively affect our earnings.

Information technology systems are critical to our business. We use various technology systems to manage our customer relationships, general ledger, securities investments, deposits, and loans. We have established policies and procedures to prevent or limit the effect of system failures, interruptions, and security breaches, but such events may still occur or may not be adequately addressed if they do occur. In addition, any compromise of our systems could deter customers from using our products and services. Although we rely on security systems to provide security and authentication necessary to effect the secure transmission of data, these precautions may not protect our systems from compromises or breaches of security.

In addition, we outsource a majority of our data processing to certain third-party providers. If these third-party providers encounter difficulties, or if we have difficulty communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely affected. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any system failures, interruption, or breach of security could damage our reputation and result in a loss of customers and business thereby subjecting us to additional regulatory scrutiny, or could expose us to litigation and possible financial liability. Any of these events could have a material adverse effect on our financial condition and results of operations.

Our risk management framework may not be effective in mitigating risk and reducing the potential for significant losses.

Our risk management framework is designed to minimize risk and loss to us. We seek to identify, measure, monitor, report and control our exposure to risk, including strategic, market, liquidity, compliance and operational risks. While we use a broad and diversified set of risk monitoring and mitigation techniques, these techniques are inherently limited because they cannot anticipate the existence or future development of currently unanticipated or unknown risks. Recent economic conditions and heightened legislative and regulatory scrutiny of the financial services industry, among other developments, have increased our level of risk. Accordingly, we could suffer losses as a result of our failure to properly anticipate and manage these risks.

Our shareholders own a minority of Waterstone Financial common stock and are not able to exercise voting control over most matters put to a vote of shareholders.

Public shareholders own a minority of the outstanding shares of Waterstone Financial common stock. As a result, public shareholders are not able to exercise voting control over most matters put to a vote of shareholders. Lamplighter Financial, MHC owns a majority of Waterstone Financial's common stock and, through its Board of directors, is able to exercise voting control over most matters put to a vote of shareholders, including possible acquisitions. The same directors who govern Waterstone Financial and WaterStone Bank also govern Lamplighter Financial, MHC. The only matters over which Lamplighter Financial, MHC is not able to exercise voting control are those requiring a separate vote of shareholders other than Lamplighter Financial, MHC.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

We operate from our corporate center, our eight full-service banking offices, our drive-through office and nine automated teller machines, located in Milwaukee, Washington and Waukesha Counties, Wisconsin. The net book value of our premises, land, and equipment was $26.9 million at December 31, 2012. The following table sets forth information with respect to our corporate center and our full-service banking offices as of December 31, 2012, all of which are owned.

Corporate Center 11200 West Plank Court Wauwatosa, Wisconsin 53226	Wauwatosa 7500 West State Street Wauwatosa, Wisconsin 53213	Franklin/Hales Corners 6555 South 108th Street Franklin, Wisconsin 53132
Germantown/Menomonee Falls W188N9820 Appleton Avenue Germantown, Wisconsin 53022	Oak Creek 6560 South 27th Street Oak Creek, Wisconsin 53154	Oconomowoc/Lake Country 1233 Corporate Center Drive Oconomowoc, Wisconsin 53066
Pewaukee 1230 George Towne Drive Pewaukee, Wisconsin 53072	Waukesha/Brookfield 21505 East Moreland Blvd Waukesha, Wisconsin 53186	West Allis 10101 West Greenfield Avenue West Allis, Wisconsin 53214

In addition to our banking offices, as of December 31, 2012, our mortgage banking operation has 16 offices in Wisconsin, 14 offices in Minnesota, 11 offices in Pennsylvania, 10 offices in Florida, four offices in each of Arizona and Indiana, three offices in Ohio, two offices in each of Idaho and Iowa, and one office in each of Illinois and Maryland.

Item 3. Legal Proceedings

We are not involved in any pending legal proceedings as a defendant other than routine legal proceedings occurring in the ordinary course of business. At December 31, 2012, we were not involved in any legal proceedings, the outcome of which would be material to our financial condition or results of operations. Other than the cease and desist order entered into with the OTS (as administered by the Federal Reserve), discussed under Item 1. Business and Item 1A. Risk Factors, we have no pending proceedings before any agency.

Item 4. Mine Safety Disclosures

Not applicable

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchase of Equity Securities

The common stock of Waterstone Financial, Inc. is traded on The NASDAQ Global Select Market® under the symbol WSBF.

As of February 28, 2013, there were 31,348,556 shares of common stock outstanding and 3,635 shareholders of record of the common stock. Waterstone Financial, Inc became a publicly-held corporation on October 4, 2005.

Waterstone Financial has never paid cash dividends on its common stock, and our board currently has no plan to pay cash dividends on the common stock. If the board considers a cash dividend in the future, the payment of dividends will depend upon a number of factors, including capital requirements, our financial condition and results of operations, tax considerations, statutory and regulatory limitations and general economic conditions and regulatory restrictions that affect our ability to pay dividends. We cannot assure you that any dividends will be paid or that, if paid, they will not be reduced or eliminated in the future. Special cash or stock dividends, to the extent permitted by applicable policy and regulation, may be paid in addition to, or in lieu of, regular cash dividends.

Our ability to pay dividends will depend, in part, upon our receipt of dividends from WaterStone Bank, because we have no significant source of income other than dividends from WaterStone Bank, earnings on our investments and interest payments on our loan to WaterStone Bank's employee stock ownership plan. Wisconsin law generally allows WaterStone Bank to pay dividends to Waterstone Financial, Inc. equal to up to 50% of WaterStone Bank's net profit in the current year without prior regulatory approval and above such amount, including out of retained earnings, with prior regulatory approval. A memorandum of understanding jointly issued by the WDFI and the FDIC effective December 5, 2012 prohibits the payment of a dividend to Waterstone Financial, Inc. without written regulatory approval.

Market Information

The high and low quarterly trading prices during fiscal 2012 and 2011 were as follows:

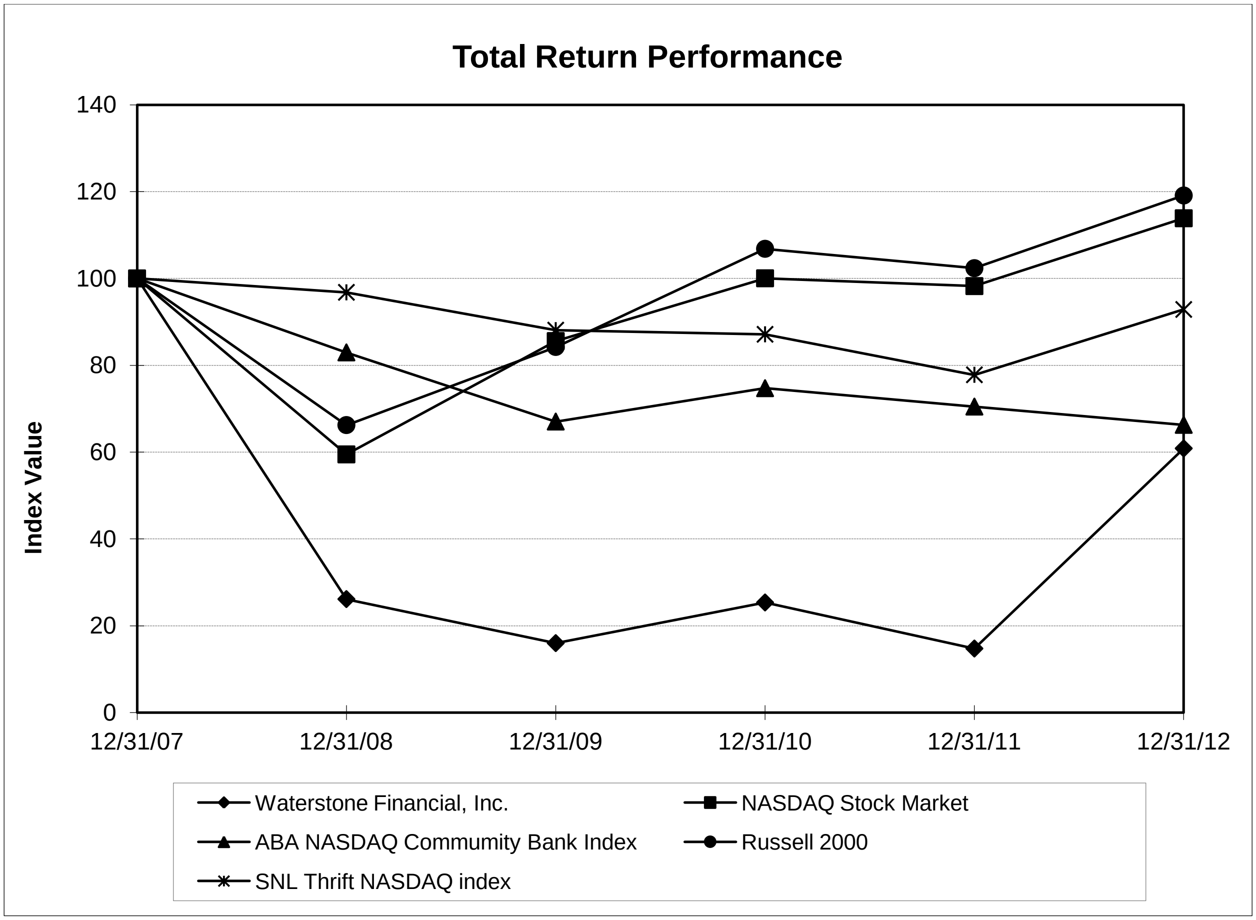
2012	High	Low
1st Quarter	$ 3.18	$ 1.78
2nd Quarter	4.05	3.01
3rd Quarter	5.19	3.33
4th Quarter	8.39	5.16

2011	High	Low
1st Quarter	$ 3.80	$ 2.40
2nd Quarter	3.22	2.25
3rd Quarter	2.83	2.50
4th Quarter	2.69	1.80

During the last two fiscal years the Company did not pay any cash dividends.

PERFORMANCE GRAPH

Set forth below is a line graph comparing the cumulative total shareholder return on Waterstone Financial common stock, based on the market price of the common stock and assuming reinvestment of cash dividends, with the cumulative total return of companies on the NASDAQ Stock Market US Index, the America's Community Bankers NASDAQ Index, the Russell 2000 and the SNL Thrift NASDAQ Index. The graph assumes $100 was invested on December 31, 2007, in Waterstone Financial common stock and each of those indices.



	Period Ending					
Index	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**
Waterstone Financial, Inc.	100.00	26.13	15.99	25.35	14.74	60.84
NASDAQ Stock Market	100.00	59.46	85.55	100.02	98.22	113.85
ABA NASDAQ Commumity Bank Index	100.00	82.95	67.03	74.71	70.47	66.27
Russell 2000	100.00	66.21	84.20	106.82	102.36	119.09
SNL Thrift NASDAQ index	100.00	96.78	88.08	87.12	77.79	92.84

Item 6. Selected Financial Data

SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

The summary financial information presented below is derived in part from the Company's audited financial statements, although the table itself is not audited. The following data should be read together with the Company's consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" later in this report.

	At or for the Year Ended December 31,				
	2012	2011	2010	2009	2008
	(In Thousands, except per share amounts)				
Selected Financial Condition					
Total assets	$ 1,661,076	$ 1,712,851	$ 1,808,966	$ 1,868,266	$ 1,885,432
Securities available for sale	205,017	206,519	203,166	205,415	179,887
Federal Home Loan Bank stock	20,193	21,653	21,653	21,653	21,653
Loans receivable, net	1,102,629	1,184,234	1,277,262	1,391,516	1,534,591
Cash and cash equivalents	71,469	80,380	75,331	71,120	23,849
Deposits	939,513	1,051,292	1,145,529	1,164,890	1,195,897
Borrowings	479,888	461,138	456,959	507,900	487,000
Total shareholders' equity	202,634	166,372	172,220	168,592	171,267
Allowance for loan losses	31,043	32,430	29,175	28,494	25,167
Selected Operating Data:					
Interest income	$ 69,846	$ 79,352	$ 89,933	$ 98,488	$ 104,078
Interest expense	27,901	32,836	40,269	54,577	63,027
Net interest income	41,945	46,516	49,664	43,911	41,051
Provision for loan losses	8,300	22,077	25,832	26,687	37,629
Net interest income after provision for loan losses	33,645	24,439	23,832	17,224	3,422
Noninterest income	91,203	43,229	38,993	12,208	6,291
Noninterest expense	102,138	74,579	64,627	40,876	33,860
Income (loss) before income taxes	22,710	(6,911)	(1,802)	(11,444)	(24,147)
Provision for income taxes (benefit)	(12,204)	562	52	(1,306)	2,299
Net income (loss)	$ 34,914	$ (7,473)	$ (1,854)	$ (10,138)	$ (26,446)
Income (loss) per share – basic	$ 1.12	$ (0.24)	$ (0.06)	$ (0.33)	$ (0.87)
Income (loss) per share – diluted	$ 1.12	$ (0.24)	$ (0.06)	$ (0.33)	$ (0.87)

	At or for the Year Ended December 31,				
	2012	**2011**	**2010**	**2009**	**2008**
Selected Financial Ratios and Other Data:					
Performance Ratios:					
Return (loss) on average assets	2.07%	(0.43%)	(0.10%)	(0.53%)	(1.44%)
Return (loss) on average equity	18.89	(4.47)	(1.09)	(6.12)	(13.76)
Interest rate spread (1)	2.45	2.67	2.67	2.21	1.99
Net interest margin (2)	2.62	2.82	2.83	2.41	2.32
Noninterest expense to average assets	6.04	4.27	3.49	2.14	1.85
Efficiency ratio (3)	76.71	83.12	72.90	72.84	71.52
Average interest-earning assets to average interest-bearing liabilities	109.84	107.67	107.11	106.68	107.85
Capital Ratios:					
Equity to total assets at end of period	12.20%	9.71%	9.52%	9.02%	9.08%
Average equity to average assets	10.94	9.55	9.18	8.67	10.44
Total capital to risk-weighted assets	17.34	14.58	14.13	13.83	12.84
Tier I capital to risk-weighted assets	16.07	13.31	12.87	12.57	11.58
Tier I capital to average assets	11.13	9.16	8.83	8.77	8.93
Asset Quality Ratios:					
Allowance for loan losses as a percent of total loans	2.74%	2.67%	2.23%	2.01%	1.61%
Allowance for loan losses as a percent of non-performing loans	41.58	41.46	34.66	37.83	23.36
Net charge-offs to average outstanding loans during the period	0.76	1.43	1.75	1.54	1.67
Non-performing loans as a percent of total loans	6.59	6.43	6.44	5.30	6.91
Non-performing assets as a percent of total assets	6.66	7.88	7.85	6.76	7.02

(1) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.
(2) Represents net interest income as a percent of average interest-earning assets.
(3) Represents non-interest expense divided by the sum of net interest income and non-interest income.

<u>Item 7.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>

Overview

Our profitability is highly dependent on our net interest income, mortgage banking income and provision for loan losses. Net interest income is the difference between the interest income we earn on our interest earning assets which are loans receivable, investment securities and cash and cash equivalents and the interest we pay on deposits and other borrowings. The Company's banking subsidiary, WaterStone Bank SSB ("WaterStone Bank" or "Bank") is primarily a mortgage lender with loans secured by real estate comprising 98.0% of total loans receivable on December 31, 2012. Further, 89.2% of loans receivable are residential mortgage loans with over four-family loans comprising 45.4% of all loans on December 31, 2012. WaterStone Bank funds loan production primarily with retail deposits and Federal Home Loan Bank advances. The Bank's mortgage banking subsidiary, Waterstone Mortgage Corporation, utilizes a line of credit provided by the Bank as a primary source of funding loans held for sale. In addition, Waterstone Mortgage Corporation utilizes short-term repurchase agreements with other banks as needed. On December 31, 2012, deposits comprised 64.4% of total liabilities. Time deposits, also known as certificates of deposit, accounted for 78.4% of total deposits at December 31, 2012. Federal Home Loan Bank advances outstanding on December 31, 2012 totaled $350.0 million, or 24.0% of total liabilities. During the current prolonged period of low interest rates and economic weakness, we have determined that an investment philosophy emphasizing short-term liquid investments including cash and cash equivalents is prudent and positions the Company to take advantage of the investment, lending and interest rate risk management opportunities that will exist as the local and national economies recover from the recession. Our high level of time deposits, relative to total deposits, will result in an increase in our cost of funds when market interest rates begin to increase.

During the year ended December 31, 2012, our results of operations were positively impacted by a significant increase in income from our mortgage banking segment and from a decrease in our provision for loans losses which resulted from an improvement in our asset quality. A significant increase in both sales volumes and margins earned on the sale of mortgage loans in the secondary market yielded a $16.2 million increase in pre-tax earnings from our mortgage banking segment during the year ended December 31, 2012 compared to the prior year. Despite pre-tax income of $22.7 million for the year ended December 31, 2012, we recognized a net income tax benefit of $12.2 million. The $12.2 million benefit was primarily the result of the December 31, 2012 full reversal of $17.0 million of remaining net deferred tax asset valuation allowances originally established in 2008.

Our provision for loan losses decreased $13.8 million to $8.3 million for the year ended December 31, 2012 as compared to $22.1 million for the year ended December 31, 2011. The decrease in provision for loan losses reflects a stabilization in both the quality of our loan portfolio and the overall local real estate market. The Company has experienced a stabilization or improvement in a number of key loan-related loan quality metrics compared to December 31, 2011, including impaired loans, loans contractually past due and non-accrual loans. In addition, the turnover of loans in each of the three aforementioned metrics has slowed during the year ended December 31, 2012 compared to the prior year, which has resulted in fewer loans requiring a specific collateral analysis to determine a potential collateral shortfall and subsequent loan loss reserve. Furthermore, as a result of stabilization in the local real estate market, those loans that have required a specific collateral review to assess the level of impairment have experienced less significant collateral shortfalls when compared to the prior year. Additional information regarding loan quality and its impact on our financial condition and results of operations can be found in the "Asset Quality" discussion.

Offsetting the positive impact of the increase in income from mortgage banking operations and a reduction of the provision for loan losses, net interest income decreased $4.6 million to $41.9 million during the year ended December 31, 2012 compared to $46.5 million during the year ended December 31, 2011. The decrease in net interest income resulted from a 20 basis point drop in our net interest margin. The yield on earning assets declined by 1.6 times the decline in the cost of funds for the year ended December 31, 2012 compared to year ended December 31, 2011.

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assumptions by management and that have, or could have, a material impact on our income or the carrying value of our assets.

Allowance for Loan Losses. WaterStone Bank establishes valuation allowances on loans deemed to be impaired. A loan is considered impaired when, based on current information and events, it is probable that WaterStone Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. A valuation allowance is established for an amount equal to the impairment when the carrying amount of the loan exceeds the present value of the expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral (specific component). The Company recognizes the change in present value of expected future cash flows on impaired loans attributable to the passage of time as bad debt expense. On an ongoing basis, at least quarterly for financial reporting purposes, the fair value of collateral dependent impaired loans and real estate owned is determined or reaffirmed by the following procedures:

- Obtaining updated real estate appraisals or performing updated discounted cash flow analysis;
- Confirming that the physical condition of the real estate has not significantly changed since the last valuation date;
- Comparison of the estimated current book value to that of updated sales values experienced on similar real estate owned;
- Comparison of the estimated current book value to that of updated values seen on more current appraisals of similar properties; and
- Comparison of the estimated current book value to that of updated listed sales prices on our real estate owned and that of similar properties (not owned by the Company).

WaterStone Bank also establishes valuation allowances based on an evaluation of the various risk components that are inherent in the credit portfolio (general component). The risk components that are evaluated include past loan loss experience; the level of non-performing and classified assets; current economic conditions; volume, growth, and composition of the loan portfolio; adverse situations that may affect the borrower's ability to repay; the estimated value of any underlying collateral; regulatory guidance; and other relevant factors. The allowance is increased by provisions charged to earnings and recoveries of previously charged-off loans and reduced by charge-offs. Charge-offs approximate the amount by which the outstanding principal balance exceeds the estimated net realizable value of the underlying collateral. The appropriateness of the allowance for loan losses is reviewed and approved quarterly by the WaterStone Bank board of directors. The allowance reflects management's best estimate of the amount needed to provide for the probable loss on impaired loans and other inherent losses in the loan portfolio, and is based on a risk model developed and implemented by management and approved by the WaterStone Bank board of directors.

Actual results could differ from this estimate, and future additions to the allowance may be necessary based on unforeseen changes in loan quality and economic conditions. More specifically, if our future charge-off experience increases substantially from our past experience; or if the value of underlying loan collateral, in our case real estate, declines in value by a substantial amount; or if unemployment in our primary market area increases significantly; our allowance for loan losses may be inadequate and we will incur higher provisions for loan losses and lower net income in the future.

In addition, state and federal regulators periodically review the WaterStone Bank allowance for loan losses. Such regulators have the authority to require WaterStone Bank to recognize additions to the allowance at the time of their examination.

Income Taxes. The Company and its subsidiaries file consolidated federal and combined state income tax returns. The provision for income taxes is based upon income in the consolidated financial statements, rather than amounts reported on the income tax return. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as for net operating loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is "more likely than not" that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, the forecasts of future income, applicable tax planning strategies, and assessments of current and future economic and business conditions. Examples of positive evidence may include the existence of taxes paid in available carry-back years as well as the probability that taxable income will be generated in future periods. Examples of negative evidence may include cumulative losses in a current year and prior two years and general business and economic trends. At December 31, 2011, the Company determined a valuation allowance originally established in 2008 continued to be necessary, largely based on the negative evidence represented by a cumulative loss in the most recent three-year period caused by the significant loan loss provisions recorded during those three years. However, the valuation allowance was fully reversed at December 31, 2012 as a result of pretax income in each of the four quarters of 2012 and for the year, the payment of federal income taxes potentially available for subsequent carry back in future periods and improvement in the Bank's asset quality metrics as well as in general economic conditions.

Positions taken in the Company's tax returns are subject to challenge by the taxing authorities upon examination. The benefit of uncertain tax positions are initially recognized in the financial statements only when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. Interest and penalties on income tax uncertainties are classified within income tax expense in the income statement.

Fair Value Measurements. The Company determines the fair value of its assets and liabilities in accordance with ASC 820. ASC 820 establishes a standard framework for measuring and disclosing fair value under GAAP. A number of valuation techniques are used to determine the fair value of assets and liabilities in the Company's financial statements. The valuation techniques include quoted market prices for investment securities, appraisals of real estate from independent licensed appraisers and other valuation techniques. Fair value measurements for assets and liabilities where limited or no observable market data exists are based primarily upon estimates, and are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the valuation results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there are inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values. Significant changes in the aggregate fair value of assets and liabilities required to be measured at fair value or for impairment are recognized in the income statement under the framework established by GAAP.

Comparison of Financial Condition at December 31, 2012 and at December 31, 2011

Total Assets. Total assets decreased by $51.8 million, or 3.0%, to $1.66 billion at December 31, 2012 from $1.71 billion at December 31, 2011. The decrease in total assets reflects decreases in loans receivable of $83.0 million and real estate owned of $20.7 million, partially offset by an increase in loans held for sale of $45.3 million. We used funds received from the repayment of loans held in portfolio, from the sale of real estate owned plus excess cash, to fund a reduction in deposits of $111.8 million, as discussed below.

Cash and Cash Equivalents. Cash and cash equivalents decreased $8.9 million, or 11.1%, to $71.5 million at December 31, 2012 from $80.4 million at December 31, 2011. The overall level of cash and cash equivalents continues to reflect our plan to maintain higher than customary liquidity given the current economic environment and relatively low rates of return available on securities and other investments.

Securities Available for Sale. Securities available for sale decreased by $1.5 million, or 0.7%, to $205.0 million at December 31, 2012 from $206.5 million at December 31, 2011. This decrease reflects a $63.3 million decrease in government sponsored enterprise bonds and a $22.1 million decrease in collateralized mortgage obligations, partially offset by an $83.6 million increase in mortgage backed securities. During the year ended December 31, 2012, the proceeds from maturities and calls of government sponsored enterprise securities and from the sale of collateralized mortgage obligations and municipal securities were primarily reinvested in mortgage-related securities, as we believe such securities provided us with a better risk-versus-reward trade-off during much of the year. During the year ended December 31, 2012, we sold $11.6 million in short-term municipal securities at a gain of $240,000. As of December 31, 2012, we held two municipal securities with a total fair value of $237,000 and amortized cost of $215,000 that were determined to be other than temporarily impaired. During the year ended December 31, 2012, $100,000 was recognized as additional other-than-temporary impairment with respect to these municipal securities and was charged against earnings. During the year ended December 31, 2012, we sold two private-label collateralized mortgage obligations for a combined gain of $282,000. At the time of sale, these securities had a combined amortized cost of $18.0 million. Each of these two securities had been previously determined to be other other-than-temporarily impaired in a prior period. During the year ended December 31, 2012, our analysis resulted in an additional $113,000 in credit losses that were charged to earnings. Life-to-date other than temporary impairment losses recognized on these two securities totaled $2.2 million.

Loans Receivable. Loans receivable held for investment decreased $83.0 million, or 6.8%, to $1.13 billion at December 31, 2012 from $1.22 billion at December 31, 2011. The 2012 decrease in total loans receivable was primarily attributable to a $35.9 million decrease in one- to four-family loans and a $37.9 million decrease in over four-family loans. The decrease in one- to four-family loans reflects a decline in loan demand for variable-rate real estate mortgage loans as borrowers continue to prefer long-term fixed-rate products that we do not generally retain in our portfolio. During the year ended December 31, 2012, $22.3 million in loans were transferred to real estate owned and $9.7 million were charged-off, net of recoveries.

Allowance for Loan Losses. The allowance for loan losses decreased $1.4 million, or 4.3%, to $31.0 million at December 31, 2012 from $32.4 million at December 31, 2011. The $1.4 million decrease in the allowance for loan losses during the year ended December 31, 2012 reflects a stabilization in both the quality of the loan portfolio as well as the overall local real estate market. We have experienced a stabilization or improvement in a number of key loan quality metrics compared to December 31, 2011, including impaired loans, substandard loans, loans contractually past due and non-accrual loans. In addition, the decrease in the allowance for loan losses reflects a decrease in the balance of loans outstanding. As of December 31, 2012, the allowance for loan losses to total loans receivable was 2.74% and was equal to 41.58% of non-performing loans, compared to 2.67% and 41.46%, respectively, at December 31, 2011. The overall $1.4 million decrease in the allowance for loan losses during the year ended December 31, 2012 was primarily the result of decreases in the allowance for loan losses related to construction and land and over four-family categories. The decrease in allowance for loan losses related to these categories resulted from both the charge-off of specific reserves as well as a decrease in the overall balance of loans outstanding. The decrease in allowance for loan losses related to these two loan categories were partially offset by an increase in allowance for loan losses related to the one- to four-family and commercial real estate categories. Increases in the allowance for loan losses related to the one- to four-family and commercial real estate categories were the result of a decrease in collateral values related to loans previously classified as impaired, as well as an increase in the overall level of commercial real estate identified as impaired. While the local real estate market has stabilized during the current fiscal year, the risk of loss on loans secured by residential real estate remains at an elevated level. That portion of the allowance for loan losses attributable to mortgage loans secured by residential real estate comprised 89.1% of the total allowance for loan losses at December 31, 2012 and 85.5% December 31, 2011.

Real Estate Owned. Total real estate owned decreased $20.7 million, or 36.5%, to $36.0 million at December 31, 2012 from $56.7 million at December 31, 2011. During the year ended December 31, 2012, $22.3 million was transferred from loans to real estate owned upon completion of foreclosure proceedings. Declines in property values evidenced by updated appraisals, responses to list prices on properties held for sale and/or deterioration in the condition of properties resulted in write downs totaling $7.6 million during the year ended December 31, 2012. During the same period, sales of real estate owned totaled $35.2 million.

Prepaid Expenses and Other Assets. Prepaid expenses and other assets increased by $18.8 million to $27.2 million at December 31, 2012 from $8.4 million at December 31, 2011. The increase is primarily due to a $16.2 million increase in deferred tax assets, which resulted from the reversal of $17.0 million in deferred income tax valuation allowances. In addition, the mortgage servicing rights intangible asset related to loans sold on a servicing retained basis increased by $3.0 million during the year ended December 31, 2012.

Deposits. Total deposits decreased $111.8 million, or 10.6%, to $939.5 million at December 31, 2012 from $1.05 billion at December 31, 2011. The reduction in deposits reflects management's decision to accept a certain level of deposit run-off during a period of diminished loan demand. Total time deposits decreased $141.8 million, or 16.1%, to $736.9 million at December 31, 2012 from $878.7 million at December 31, 2011. The decrease in time deposits was partially offset by an increase in money market and demand deposits. Total money market and savings deposits increased $14.4 million, or 13.8%, to $118.5 million at December 31, 2012 from $104.1 million at December 31, 2011. Total demand deposits increased $15.7 million, or 22.9%, to $84.1 million at December 31, 2012 from $68.5 million at December 31, 2011.

Borrowings. Total borrowings increased $18.8 million, or 4.1%, to $479.9 million at December 31, 2012 from $461.1 million at December 31, 2011. The increase in borrowings relates entirely to an increase in the use of short-term repurchase agreements to finance loans held for sale. The outstanding balance of these short-term repurchase agreements increased by $18.8 million, to $45.9 million at December 31, 2012, from $27.1 million at December 31, 2011.

Other Liabilities. Other liabilities increased $4.3 million, or 12.9%, to $37.4 million at December 31, 2012 from $33.1 million at December 31, 2011. The increase resulted primarily from an increase in accrued compensation and accrued expenses due to third parties related to our mortgage banking operations.

Shareholders' Equity. Shareholders' equity increased by $36.3 million, or 21.8%, to $202.6 million at December 31, 2012 from $166.4 million at December 31, 2011. The increase in shareholders' equity was primarily due to a $34.9 million increase in retained earnings reflecting net income for the year ended December 31, 2012. In addition to the increase in retained earnings, shareholders' equity was positively impacted by an $897,000 increase in accumulated other comprehensive income and an $854,000 decrease in unearned ESOP shares.

Average Balance Sheets, Interest and Yields/Costs

The following tables set forth average balance sheets, average yields and costs, 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. Non-accrual loans were included in the computation of average balances. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income or expense.

	At December 31, 2012	Years Ended December 31, 2012			2011			2010		
	Yield/Rate	**Average Balance**	**Interest**	**Average Rate**	**Average Balance**	**Interest**	**Average Rate**	**Average Balance**	**Interest**	**Average Rate**
					(Dollars in Thousands)					
Interest-earning assets:										
Loans receivable and held for sale	5.00%	$ 1,276,271	64,317[1]	5.03%	$ 1,314,068	72,269[1]	5.50%	$ 1,440,417	$ 81,161[1]	5.63%
Mortgage related securities [5]	2.05	138,133	3,278	2.37	94,099	3,822	4.06	107,406	5,360	4.99
Debt securities, federal funds sold and short-term investmetns [5] [6]	1.65	180,117	2,251	1.25	239,400	3,261	1.36	206,066	3,412	1.66
Total interest-earning assets	4.41	1,594,521	69,846	4.37	1,647,567	79,352	4.82	1,753,889	89,933	5.13
Noninterest-earning assets		95,222			101,671			97,215		
Total assets		$ 1,689,743			$ 1,749,238			$ 1,851,104		
Interest-bearing liabilities:										
Demand accounts	0.03	39,818	24	0.06	38,328	30	0.08	37,852	37	0.10
Money market and savings accounts	0.15	127,261	273	0.21	120,231	369	0.31	110,479	495	0.45
Certificates of deposit	0.83	809,446	9,180	1.13	925,209	14,890	1.61	1,007,304	20,457	2.03
Total interest-bearing deposits	0.70	976,525	9,477	0.97	1,083,768	15,289	1.41	1,155,635	20,989	1.82
Borrowings	3.82	475,114	18,424	3.87	446,401	17,547	3.93	481,808	19,280	4.00
Total interest-bearing liabilities	1.82	1,451,639	27,901	1.92	1,530,169	32,836	2.15	1,637,443	40,269	2.46
Noninterest-bearing liabilities										
Non-interest bearing deposits		33,500			28,917			26,940		
Other non-interest bearing liabilities		19,817			23,099			16,789		
Total non-interest bearing liabilities		53,317			52,016			43,729		
Total liabilites		1,504,956			1,582,185			1,681,172		
Equity		184,787			167,053			169,932		
Total liabilities and equity		$ 1,689,743			$ 1,749,238			$ 1,851,104		
Net interest income			41,945			46,516			49,664	
Net interest rate spread [2]				2.45%			2.67%			2.67%
Net interest-earning assets [3]		$ 142,882			$ 117,398			$ 116,446		
Net interest margin [4]				2.62%			2.82%			2.83%
Average interest-earning assets to average interest-bearing liabilities		109.84%			107.67%			107.11%		

(1) Includes net deferred loan fee amortization income of $657,000, $636,000 and $739,000 for the years ended December 31, 2012, 2011 and 2010, respectively.
(2) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
(3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
(4) Net interest margin represents net interest income divided by average total interest-earning assets.
(5) Average balance of available for sale securities is based on amortized historical cost.
(6) Interest income from tax exempt securities is not significant to total interest income, therefore, interest and yield on interest earnings assets are not stated on a tax equivalent basis. The average balance of tax exempt securities totaled $19.1 million, $27.6 million and $24.0 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income for the periods indicated. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	Years Ended December 31, 2012 vs. 2011 Increase (Decrease) due to			Years Ended December 31, 2011 vs. 2010 Increase (Decrease) due to		
	Volume	Rate	Net	Volume	Rate	Net
			(In Thousands)			
Interest and dividend income:						
Loans receivable and held for sale[(1) (2)]	$ (1,990)	(5,962)	(7,952)	$ (6,985)	(1,907)	(8,892)
Mortgage related securites	1,399	(1,943)	(544)	(615)	(923)	(1,538)
Other interest-earning assets	(752)	(258)	(1,010)	505	(656)	(151)
Total interest-earning assets	(1,343)	(8,163)	(9,506)	(7,095)	(3,486)	(10,581)
Interest expense:						
Demand accounts	1	(7)	(6)	-	(7)	(7)
Money market and savings accounts	21	(117)	(96)	41	(167)	(126)
Certificates of deposit	(1,692)	(4,018)	(5,710)	(1,570)	(3,997)	(5,567)
Total interest-bearing deposits	(1,670)	(4,142)	(5,812)	(1,529)	(4,171)	(5,700)
Borrowings	1,154	(277)	877	(1,384)	(349)	(1,733)
Total interest-bearing liabilities	(516)	(4,419)	(4,935)	(2,913)	(4,520)	(7,433)
Net change in net interest income	$ (827)	(3,744)	(4,571)	$ (4,182)	1,034	(3,148)

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(1) Includes net deferred loan fee amortization income of $657,000, $636,000 and $739,000 for the years ended December 31, 2012, 2011 and 2010, respectively.
(2) Non-accrual loans have been included in average loans receivable balance.

Comparison of Operating Results for the Years Ended December 31, 2012 and 2011

General. Net income for the year ended December 31, 2012 totaled $34.9 million, or $1.12 for both basic and diluted income per share, compared to a net loss of $7.5 million, or $0.24 for both basic and diluted loss per share, for the year ended December 31, 2011. The year ended December 31, 2012 generated a return on average assets of 2.07% and a return on average equity of 18.89%, compared to a loss on average assets of 0.43% and a loss on average equity of 4.47% for the year ended December 31, 2011. The results of operations for the year ended December 31, 2012 as compared to the year ended December 31, 2011 reflect a $16.2 million increase in the pre-tax results of operations from our mortgage banking operations, a $12.8 million increase in income tax benefit due to a reversal of $17.0 million of remaining net deferred tax asset valuation allowances, a $13.8 million decrease in the provision for loan losses and a $3.4 million decrease in expense related to real estate owned, which were partially offset by a $4.6 million decrease in net interest income.

Segment Review. As described in Note 19 of the notes to consolidated financial statements, we have two reportable segments: community banking and mortgage banking.

Community banking consists of lending and deposit generation (as well as other banking-related products and services) to consumers and businesses and the support to deliver, fund, and manage such banking services. Our mortgage banking segment provides residential mortgage products for the purpose of sale on the secondary market. As such, it is a transaction based business. Transaction volume can vary significantly from period to period based upon changes in market interest rates and other economic and regulatory factors.

Mortgage banking segment assets (which consist predominantly of loans held for sale) increased $47.5 million, or 47.4%, to $147.7 million as of December 31, 2012 compared to $100.2 million as of December 31, 2011. Mortgage banking segment revenues increased $47.1 million, or 115.6%, to $87.9 million for the year ended December 31, 2012 compared to $40.8 million during the year ended December 31, 2011. The $47.1 million increase in mortgage banking revenues was attributable to both an increase in loan origination volume, as well as increased margins. Loans originated for sale in the secondary market totaled $1.7 billion during the year ended December 31, 2012, representing a $722.1 million, or 70.3%, increase in originations from the year ended December 31, 2011, which totaled $1.0 billion. In addition to the increase in revenues resulting from the increase in origination volume, mortgage banking revenues increased due to an increase in average sales margin. The increase in average sales margin was driven by an increase in pricing on products in all geographic markets. The major components of mortgage banking revenues include fees and premiums associated with the sale of residential loans held for sale, which are discussed in "Noninterest Income." The major expenses for the mortgage banking segment are compensation, payroll taxes and other employee benefits, as well as occupancy, office furniture and equipment and other expenses, which are covered generally in the consolidated discussion in "Noninterest Expense."

Total Interest Income. Total interest income decreased $9.5 million, or 12.0%, to $69.8 million during the year ended December 31, 2012 from $79.4 million during the year ended December 31, 2011. This decrease was the result of a decrease in the average yield on interest earnings assets and a decrease in the average balance of interest earnings assets. The average yield on interest earning assets decreased 45 basis points to 4.37% for the year ended December 31, 2012 from 4.82% for the year ended December 31, 2011. The average balance of interest earning assets decreased $53.0 million to $1.60 billion for the year ended December 31, 2012 from $1.65 billion for the year ended December 31, 2011.

Interest income on loans decreased $8.0 million, or 11.0%, to $64.3 million during the year ended December 31, 2012 from $72.3 million during the year ended December 31, 2011. The decrease in interest income was primarily due to a 47 basis point decrease in the average yield on loans to 5.03% for the year ended December 31, 2012 from 5.50% for the year ended December 31, 2011. The decrease in interest income on loans also reflects a $37.8 million, or 2.9%, decrease in the average balance of loans outstanding to $1.28 billion during the year ended December 31, 2012 from $1.31 billion during the year ended December 31, 2011.

Interest income from mortgage-related securities decreased $544,000, or 14.2%, to $3.3 million during the year ended December 31, 2012 from $3.8 million during the year ended December 31, 2011. The decrease in interest income was due to a 169 basis point decrease in the average yield on mortgage-related securities to 2.37% for the year ended December 31, 2012 from 4.06% for the year ended December 31, 2011. The decrease in average yield resulted from a general turnover of the investment securities portfolio in the current, historically low, interest rate environment. The decrease in average yield was partially offset by a $44.0 million, or 46.8%, increase in the average balance of mortgage-related securities to $138.1 million for the year ended December 31, 2012 from $94.1 million during the year ended December 31, 2011.

Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) decreased $1.0 million, or 31.0%, to $2.3 million for the year ended December 31, 2012 from $3.3 million for the year ended December 31, 2011. Interest income decreased due to a decrease of $59.3 million, or 24.8%, in the average balance of other earning assets to $180.1 million during the year ended December 31, 2012 from $239.4 million during the year ended December 31, 2011. The decrease in interest income from other earning assets also reflects an 11 basis point decline in the average yield on other earning assets to 1.25% for the year ended December 31, 2012 from 1.36% for the year ended December 31, 2011. During the year ended December 31, 2012, the debt security portfolio decreased as a result of $71.1 million in maturities and $11.8 million in sales. A substantial portion of the proceeds from maturities and sales of debt securities were reinvested in mortgage-related securities.

Total Interest Expense. Total interest expense decreased by $4.9 million, or 15.0%, to $27.9 million during the year ended December 31, 2012 from $32.8 million during the year ended December 31, 2011. This decrease was the result of both a decrease in the average cost of funds as well as a decrease in the average balance of interest bearing deposits and borrowings. The average cost of funds decreased 23 basis points to 1.92% for the year ended December 31, 2012 from 2.15% for the year ended December 31, 2011. The decrease in interest expense was also due to a decrease of $78.5 million, or 5.1%, in the average balance of interest-bearing liabilities to $1.45 billion during the year ended December 31, 2012 from $1.53 billion during the year ended December 31, 2011

Interest expense on deposits decreased $5.8 million, or 38.0%, to $9.5 million during the year ended December 31, 2012 from $15.3 million during the year ended December 31, 2011. The decrease in interest expense on deposits was primarily due to a 44 basis point decrease in the cost of average deposits to 0.97% for the year ended December 31, 2012 from 1.41% for the year ended December 31, 2011. The decrease in the cost of deposits reflects the current low market interest rate environment due to the Federal Reserve Board's low short-term interest rate policy. These rates are typically used by financial institutions in pricing deposits. The decrease in the cost of deposits also reflects a shift in the composition of deposits from higher cost time deposits to lower cost demand, money market and savings accounts. The decrease in interest expense attributable to the decrease in the cost of deposits was compounded by a decrease of $107.2 million, or 9.9%, in the average balance of interest-bearing deposits to $976.5 million during the year ended December

31, 2012 from $1.08 billion during the year ended December 31, 2011. The decrease in average interest-bearing deposits was exclusively the result of a decrease in time deposits, which carry a higher cost than demand, money market or savings accounts. The decrease in time deposits was consistent with our liquidity needs and funding obligations.

Interest expense on borrowings increased $877,000, or 5.0%, to $18.4 million during the year ended December 31, 2012 from $17.5 million during the year ended December 31, 2011. The increase resulted from a $28.7 million, or 6.4%, increase in average borrowings outstanding to $475.1 million during the year ended December 31, 2012 from $446.4 million during the year ended December 31, 2011. The increased use of borrowings as a funding source during the year ended December 31, 2012 reflects an increased use of short-term repurchase agreements by our mortgage banking segment to fund loan originations to be sold in the secondary market. The average cost of borrowings decreased 6 basis points to 3.87% during the year ended December 31, 2012 compared to 3.93% during the year ended December 31, 2011.

Net Interest Income. Net interest income decreased by $4.6 million, or 9.8%, to $41.9 million during the year ended December 31, 2012 as compared to $46.5 million during the year ended December 31, 2011. The decrease in net interest income resulted primarily from a 22 basis point decrease in our interest rate spread to 2.45% during the year ended December 31, 2012 from 2.67% during the year ended December 31, 2011. The 22 basis point decrease in the interest rate spread resulted from a 45 basis point decrease in the average yield on interest earning assets, which was only partially offset by a 23 basis point decrease in the average cost of interest bearing liabilities.

Provision for Loan Losses. Our provision for loan losses decreased $13.8 million, or 62.4%, to $8.3 million during the year ended December 31, 2012, from $22.1 million during the year ended December 31, 2011. The decrease in the provision for loan losses resulted from a decrease in loans exhibiting risk characteristics that require estimated loan loss provisions in excess of our historical average experience when compared to the same period of the prior year. While the provision for loan losses has decreased from the prior year, it remains at historical high levels. These levels remain high due to continued general economic stress resulting in reduced levels of income earned by many of our borrowers combined with loan collateral values, primarily real estate, that remain at levels below those estimated at the time the loans were originally made. These factors result in higher levels of actual loss experience which, when applied to the portfolio in general, require higher loan loss provisions. The provision for the year ended December 31, 2012 reflects $9.7 million of net loan charge-offs. See the “Asset Quality” section for an analysis of charge-offs, nonperforming assets, specific reserves and additional provisions.

Noninterest Income. Total noninterest income increased $48.0 million, or 111.0%, to $91.2 million during the year ended December 31, 2012 from $43.2 million during the year ended December 31, 2011. The increase resulted from an increase in mortgage banking income.

Mortgage banking income increased $47.5 million, or 119.3%, to $87.4 million for the year ended December 31, 2012, compared to $39.8 million during the year ended December 31, 2011. The $47.5 million increase in mortgage banking income was the result of increased origination and sales volumes as well as an increase in average sales margins. The increase in average sales margins reflects an increase in pricing and fees on all products in all geographic markets, which was consistent with the industry as a whole.

Despite the increase in pricing, overall loan origination volumes increased significantly compared to the prior year reflecting the continued strong demand for fixed-rate loans carrying historically low interest rates. Loans originated for sale in the secondary market totaled $1.75 billion during the year ended December 31, 2012, which represents a $722.1 million, or 70.3%, increase in originations from the year ended December 31, 2011, which totaled $1.03 billion.

Our overall margin can be affected by the mix of both loan type (conventional loans versus governmental) and loan purpose (purchase versus refinance). During the year ended December 31, 2012, the growth in loan origination volume resulted in a shift towards lower yielding conventional loans and loans made for the purposes of refinancing; however, margins increased for all loan types and loan purpose, compared to the year ended December 31, 2011. Loans originated to purchase residential property, which generally yield a higher margin than loans originated to refinance an existing loan, comprised 55.4% of total originations during the year ended December 31, 2012, compared to 65.1% during the year ended December 31, 2011. The mix of loan type changed slightly with conventional loans and governmental loans comprising 67.3% and 32.7% of all loan originations, respectively, during the year ended December 31, 2012. During the year ended December 31, 2011 conventional loans and governmental loans comprised 61.6% and 38.4% of all loan originations, respectively. Conventional loans include loans that conform to Fannie Mae and Freddie Mac standards, whereas governmental loans are those loans guaranteed by the federal government, such as a Federal Housing Authority or U.S. Department of Agriculture.

Noninterest Expense. Total noninterest expense increased $27.6 million, or 37.0%, to $102.1 million during the year ended December 31, 2012 from $74.6 million during the year ended December 31, 2011. The increase was primarily attributable to increased compensation and other noninterest expense related to our mortgage banking segment.

Compensation, payroll taxes and other employee benefit expense increased $24.3 million, or 62.2%, to $63.5 million during the year ended December 31, 2012 compared to $39.2 million during the year ended December 31, 2011. Due primarily to an increase in loan origination activity, total compensation, payroll taxes and other employee benefits at our mortgage banking subsidiary increased $23.8 million, or 88.5%, to $50.7 million for the year ended December 31, 2012 from $26.9 million during the year ended December 31, 2011. The increase in compensation expense at our mortgage banking subsidiary resulted from the increase in mortgage banking income and higher compensation for our mortgage banking loan officers under commission based compensation structure. Compensation, payroll taxes and other employee benefits at our banking segment increased $418,000, or 3.2%, to $13.4 million for the year ended December 31, 2012 compared to $13.0 million during the year ended December 31, 2011.

Real estate owned expense decreased $3.4 million, or 28.0%, to $8.7 million during the year ended December 31, 2012 from $12.1 million during the year ended December 31, 2011. Real estate owned expense includes the operating costs related to the properties, net of rental income. In addition, it includes net gain or loss recognized upon the sale of foreclosed property, as well as write-downs recognized to maintain the properties at the lower of cost or estimated fair value. The decrease in real estate owned expense results from a decrease in net property management expense and an increase in net gains on the sales of properties, partially offset by an increase in write-downs of asset values. During the year ended December 31, 2012, net operating expense, which includes property taxes, maintenance and management fees, net of rental income, decreased $3.5 million, or 57.6%, to $2.6 million from $6.1 million during the year ended December 31, 2011. The decrease in net operating expense compared to the prior period resulted from both an improvement in the operating results of income producing properties as well as a decrease in the number and balance of properties owned. Total real estate owned decreased $20.7 million, or 36.5%, to $36.0 million at December 31, 2012 from $56.7 million at December 31, 2011. Net losses recognized on the sale or write-down of real estate owned totaled $6.2 million during the year ended December 31, 2012, compared to $6.1 million during the year ended December 31, 2011.

Other noninterest expense increased $4.6 million, or 61.9%, to $12.0 million during the year ended December 31, 2012 from $7.4 million during the year ended December 31, 2011. The increase resulted from a $4.6 million increase in operational costs related to the expansion of our mortgage banking operations to $10.5 million for the year ended December 31, 2012, compared to $5.9 million during the year ended December 31, 2011.

Income Taxes. Despite pre-tax income of $22.7 million for the year ended December 31, 2012, we recognized a net income tax benefit of $12.2 million. The $12.2 million benefit was primarily the result of the December 31, 2012 full reversal of $17.0 million of remaining net deferred tax asset valuation allowances originally established in 2008. From 2008 until the end of 2012, a valuation allowance was necessary largely because of cumulative losses for three or more consecutive years as a result of significant loan loss provisions and related asset quality issues, combined with real estate instability and general economic weakness. At December 31, 2012, however, pretax income in each of the four quarters of 2012 and for the year, the existence of federal income taxes paid during the year ended December 31, 2012 and available for carry back in future years, the stabilization of real estate markets and general improvements in economic conditions indicated that it was more likely than not that net deferred tax assets will be realized in future periods. The $17.0 million in deferred federal and state income tax benefit for the year ended December 31, 2012 was partially offset by $4.7 million in current federal and state income tax expense.

Despite a pre-tax loss, we recorded income tax expense of $562,000 for the year ended December 31, 2011. Tax expense is comprised of current estimated expense of $1.2 million resulting from an IRS audit of tax years 2005 through 2009 which is still in progress, plus current estimated state income tax expense of $74,000 related to mortgage banking operations apportioned to states in which taxes are based on separate company operations. This was partially offset by current income tax benefit of $736,000 for an intra-period tax allocation between other comprehensive income and loss from continuing operations, and represents an out-of-period adjustment for an error that originated in 2008 which was corrected during the quarter ended June 30, 2011. The correction of the error was not material to the year ended December 31, 2011.

Comparison of Operating Results for the Years Ended December 31, 2011 and 2010

General. Net loss for the year ended December 31, 2011 totaled $7.5 million, or $0.24 for both basic and diluted loss per share, compared to a net loss of $1.9 million, or $0.06 for both basic and diluted loss per share, for the year ended December 31, 2010. For the year ended December 31, 2011 we had a loss on average assets of 0.43% and a loss on average equity of 4.47%, compared to a loss on average assets of 0.10% and a loss on average equity of 1.09% for the year ended December 31, 2010. The results of operations for the year ended December 31, 2011 as compared to the year ended December 31, 2010 reflect a $5.6 million increase in real estate owned expense, a $3.1 million decrease in net interest income and a $1.1 million decrease in pre-tax results of operations from our mortgage banking subsidiary partially offset by a $3.8 million reduction in the provision for loan losses.

Segment Review. As described in Note 19, "Segment Reporting," of the notes to consolidated financial statements, our primary reportable segment is community banking. Community banking consists of lending and deposit gathering (as well as other banking-related products and services) to consumers and businesses and the support to deliver, fund, and manage such banking services. Our mortgage banking segment provides residential mortgage products for the purpose of sale on the secondary market.

Mortgage banking segment assets (which consist predominantly of loans held for sale) decreased $8.8 million, or 8.0%, to $100.2 million as of December 31, 2011 compared to $108.9 million as of December 31, 2010. A $4.4 million increase in mortgage banking revenues was attributable to increased margins on the sale of loans held for sale. The major components of mortgage banking revenues include fees and premiums associated with the sale of residential loans held for sale, which are discussed below in "—Noninterest income." The major expenses for the mortgage banking segment are compensation, payroll taxes and other employee benefits, as well as occupancy, office furniture and equipment and other expenses, which are covered generally in the consolidated discussion below in "—Noninterest Expense."

Total Interest Income. Total interest income decreased $10.6 million, or 11.8%, to $79.4 million during the year ended December 31, 2011 from $89.9 million during the year ended December 31, 2010.

Interest income on loans decreased $8.9 million, or 11.0%, to $72.3 million during the year ended December 31, 2011 from $81.2 million during the year ended December 31, 2010. The decrease in interest income was primarily due to a $126.3 million, or 8.8%, decrease in the average balance of loans outstanding to $1.31 billion during the year ended December 31, 2011 from $1.44 billion during the year ended December 31, 2010. The decrease in interest income on loans also reflects a 13 basis point decrease in the average yield on loans to 5.50% for the year ended December 31, 2011 from 5.63% for the year ended December 31, 2010.

Interest income from mortgage-related securities decreased $1.5 million, or 28.7%, to $3.8 million during the year ended December 31, 2011 from $5.4 million during the year ended December 31, 2010. The decrease in interest income was primarily due to a 93 basis point decrease in the average yield on mortgage-related securities to 4.06% for the year ended December 31, 2011 from 4.99% during the year ended December 31, 2010. The decrease in interest income from mortgage-related securities also reflects a $13.3 million, or 12.4%, decrease in the average balance of mortgage-related securities to $94.1 million for the year ended December 31, 2011 from $107.4 million during the year ended December 31, 2010. The decline in the average balance of mortgage-related securities during the year ended December 31, 2011 reflects management's decision to deemphasize investments in mortgage-related securities and emphasize more liquid, less volatile, government agency and municipal securities.

Finally, interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) decreased to $3.3 million for the year ended December 31, 2011 compared to $3.4 million for the year ended December 31, 2010. Interest income decreased due to a 30 basis point decline in the average yield on other earning assets to 1.36% for the year ended December 31, 2011 from 1.66% for the year ended December 31, 2010. The decline in average yield provided by these assets reflects the lower overall interest rate environment as opposed to a shift in investment strategy and product mix. The decrease in interest income due to a decline in average yield was partially offset by an increase of $33.3 million, or 16.2%, in the average balance of other earning assets to $239.4 million during the year ended December 31, 2011 from $206.1 million during the year ended December 31, 2010. The increase in average balance reflects a strategic shift towards investments which provide higher levels of liquidity. We intend to maintain higher than usual liquidity given the current economic environment and relatively low rates of return available on loans and mortgage related securities.

Total Interest Expense. Total interest expense decreased by $7.4 million, or 18.5%, to $32.8 million during the year ended December 31, 2011 from $40.3 million during the year ended December 31, 2010. This decrease was the result of a decrease of 31 basis points in the average cost of funds to 2.15% for the year ended December 31, 2011 from 2.46% for the year ended December 31, 2010. The decrease in interest expense resulted from a decrease in the average cost of funds as well as a decrease of $107.3 million, or 6.6%, in average interest bearing deposits and borrowings outstanding to $1.53 billion for the year ended December 31, 2011 compared to an average balance of $1.64 billion for the year ended December 31, 2010.

Interest expense on deposits decreased $5.7 million, or 27.2%, to $15.3 million during the year ended December 31, 2011 from $21.0 million during the year ended December 31, 2010. This was due to a decrease in the cost of average deposits of 41 basis points to 1.41% for the year ended December 31, 2011 compared to 1.82% for the year ended December 31, 2010. The decrease in the cost of deposits reflects the low interest rate environment due to the Federal Reserve Board's low short-term interest rate policy. These rates are typically used by financial institutions in pricing deposit products. The decrease in interest expense attributable to the decrease in the cost of deposits was compounded by a decrease of $71.9 million, or 6.2%, in the average balance of interest bearing deposits to $1.08 billion during the year ended December 31, 2011 from $1.16 billion during the year ended December 31, 2010. During the year ended December 31, 2011, proceeds received from the loan principal pay downs were primarily utilized to maintain a higher than normal level of liquidity. Consistent with our liquidity needs and funding obligations we reduced our level of higher cost time deposits during the year ended December 31, 2011.

Interest expense on borrowings decreased $1.7 million, or 9.0%, to $17.5 million during the year ended December 31, 2011 from $19.3 million during the year ended December 31, 2010. The decrease resulted from a $35.4 million, or 7.3%, decrease in average borrowings outstanding to $446.4 million during the year ended December 31, 2011 from $481.8 million during the year ended December 31, 2010. The decrease in interest expense resulted from a decrease in the average balance as well as a decrease in the cost of borrowings of seven basis points to 3.93% for the year ended December 31, 2011 compared to 4.00% for the year ended December 31, 2010. The decreased use of borrowings as a source of funding during the year ended December 31, 2011 reflects our decision to utilize core deposits as our primary funding source.

Net Interest Income. Net interest income decreased by $3.1 million, or 6.3%, to $46.5 million during the year ended December 31, 2011 as compared to $49.7 million during the year ended December 31, 2010. The decrease in net interest income resulted primarily from a reduction in the loan portfolio during the year and a change in the composition of interest earning assets that became more weighted towards lower yielding other earning assets during the year ended December 31, 2011 as compared to the year ended December 31, 2010, partially offset by a decrease in time deposits and borrowings during the year ended December 31, 2011.

Provision for Loan Losses. Our provision for loan losses decreased $3.8 million, or 14.5%, to $22.1 million during the year ended December 31, 2011, from $25.8 million during the year ended December 31, 2010. While the provision for loan losses has decreased from the prior year, it remains at high levels. These levels remain high due to continued general economic stress resulting in reduced levels of income earned by many of our borrowers combined with loan collateral values, primarily real estate, that remain at levels below those estimated at the time the loans were originally made. These factors result in higher levels of actual loss experience which when applied to the portfolio in general require higher loan loss provisions. They also result in more loans exhibiting risk characteristics that require estimated loan loss provisions in excess of our historical average experience rates. These risk characteristics include reduced borrower cash flow, reduced borrower FICO scores and known declines in collateral value even though the loan may still be performing. The provision for the year ended December 31, 2011 reflects $18.8 million of net loan charge-offs combined with continued weakness in local real estate markets which required an overall increase to the allowance for loan losses.

Noninterest Income. Total noninterest income increased $4.2 million, or 10.9%, to $43.2 million during the year ended December 31, 2011 from $39.0 million during 2010. The increase resulted primarily from an increase in mortgage banking income.

Mortgage banking income increased $4.4 million, or 12.4%, to $39.8 million for the year ended December 31, 2011, compared to $35.5 million during the year ended December 31, 2010. The $4.4 million increase in mortgage banking income was primarily the result of an increase in average sales margin which was driven by the following factors: an increase in pricing on all products in all geographic markets, a change in product mix towards real estate purchase loans which yield a higher margin than loans originated for the purpose of a refinancing and change in the geographic composition of origination activity towards higher yielding geographic markets.

Despite the increase in pricing, overall loan origination volumes remained relatively consistent which reflects the continued strong demand for fixed-rate loans due in large part to historically low interest rates on these products. While the loan origination volume remained relatively consistent during the years ended December 31, 2011 and 2010, there was a shift in the mix of loan purpose toward loans originated for the purpose of a residential property purchase, which yield a higher return, as opposed to a loan originated for the purpose of refinancing an existing mortgage loan. During the year ended December 31, 2011, approximately 64% of all loans were originated for purchase and 36% were originated to refinance an existing loan. During the year ended December 31, 2010, approximately 45% of all loans were originated for purchase and 55% were originated to refinance an existing loan. In addition to the shift in product mix during the year ended December 31, 2011, there was a shift in origination volume by geographic market. Loan origination volumes increased by a combined $164.1 million during the year ended December 31, 2011 as compared to the year ended December 31, 2010 with respect to three of our higher yielding geographic markets. In addition, during the same time frame, loan origination volumes decreased by approximately $165.5 million in one of our lower yielding geographic markets. While margins increased in all markets, this shift in origination volumes by market resulted in higher average margins during the year ended December 31, 2011.

Noninterest Expense. Total noninterest expense increased $10.0 million, or 14.4%, to $74.6 million during the year ended December 31, 2011 from $64.6 million during the year ended December 31, 2010. The increase was primarily attributable to increased compensation, real estate owned expense and other noninterest expense.

Compensation, payroll taxes and other employee benefit expense increased $2.8 million, or 7.8%, to $39.2 million during the year ended December 31, 2011 compared to $36.3 million during the year ended December 31, 2010. The increase in compensation is primarily the result of an increase in commissions paid to loan originators by our mortgage banking subsidiary and correlates to the increase in mortgage banking income. Loan commissions increased by $2.9 million, or 40.0% to $10.0 million for the year ended December 31, 2011 from $7.2 million during the year ended December 31, 2010.

Real estate owned expense increased $5.6 million, or 84.4%, to $12.1 million during the year ended December 31, 2011 from $6.6 million during the year ended December 31, 2010. Real estate owned expense includes the net operating and carrying costs related to the properties. In addition, it includes net gain or loss recognized upon the sale of a foreclosed property, as well as write-downs recognized to maintain the properties at their estimated fair value. The increase in real estate owned expense results from an increase in properties under management and an increase in write downs of asset values, which is reflective of a strategy to become more aggressive in pricing specific properties to expedite the sale process. During the year ended December 31, 2011, net operating expense, which includes but is not limited to property taxes, maintenance and management fees, net of rental income increased $180,000, or 3.0%, to $6.1 million from $5.9 million during the year ended December 31, 2010. The increase in net operating expense compared to the prior period resulted from an increase in the number of properties owned. The average balance of real estate owned totaled $60.3 million for the year ended December 31, 2011 compared to $53.7 million for the year ended December 31, 2010. Net losses recognized on write-down of real estate owned net of net gains on sales totaled $6.1 million during the year ended December 31, 2011, compared to $675,000 during the year ended December 31, 2010.

Other noninterest expense increased $1.0 million, or 15.8%, to $7.4 million during the year ended December 31, 2011 from $6.4 million during the year ended December 31, 2010. The increase resulted from an increase in operational costs related to the expansion of our mortgage banking operations to $5.9 million for the year ended December 31, 2011 from $4.6 million during 2010.

Income Taxes. Despite a pre-tax loss, we recorded income tax expense of $562,000 for the year ended December 31, 2011. Tax expense is comprised of current estimated expense of $1.2 million resulting from an Internal Revenue Service audit of tax years 2005 through 2009, plus current estimated state income tax expense of $74,000 related to mortgage banking operations apportioned to states in which taxes are based on separate company operations. These were partially offset by current income tax benefit of $736,000 for an intra-period tax allocation between other comprehensive income and loss from continuing operations, and represents an out-of-period adjustment for an error that originated beginning in 2008 that was corrected during the quarter ended June 30, 2011. The correction of the error was not material to the years ended December 31, 2011 or 2010.

Despite a pre-tax loss, we recorded income tax expense of $52,000 for the year ended December 31, 2010 primarily due to differences between prior year estimates and actual tax returns filed plus state income tax due to taxable income generated by the mortgage banking subsidiary. Due to the valuation allowance on our deferred tax assets, we were not able to record an income tax benefit related to the pre-tax loss incurred. A current income tax benefit that would normally result from a pre-tax loss was offset by additional deferred tax expense due to an increase in the required valuation allowance.

Liquidity and Capital Resources

We maintain liquid assets at levels we consider adequate to meet our liquidity needs. Our liquidity ratio averaged 5.1% and 6.2% for the years ended December 31, 2012 and 2011. The liquidity ratio is equal to average daily cash and cash equivalents for the period divided by average total assets. We adjust our liquidity levels to fund loan commitments, repay our borrowings, fund deposit outflows and pay real estate taxes on mortgage loans. We also adjust liquidity as appropriate to meet asset and liability management objectives. The operational adequacy of our liquidity position at any point in time is dependent upon the judgment of the Chief Financial Officer as supported by the full Asset/Liability Committee. Liquidity is monitored on a daily, weekly and monthly basis using a variety of measurement tools and indicators. Regulatory liquidity, as required by the Wisconsin Department of Financial Institutions, is based on current liquid assets as a percentage of the prior month's average deposits and short-term borrowings. Minimum primary liquidity is equal to 4.0% of deposits and short-term borrowings and minimum total regulatory liquidity is equal to 8.0% of deposits and short-term borrowings. The Bank's primary and total regulatory liquidity at December 31, 2012 were 11.69% and 17.38%, respectively.

Our primary sources of liquidity are deposits, repayment of loans, sales of loans held for sale, maturities of investment securities and other short-term investments, and earnings and funds provided from operations. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows, loan prepayments and the origination and sale of loans held for sale are greatly influenced by market interest rates, economic conditions, and rates offered by our competitors. We set the interest rates on our deposits to maintain a desired level of total deposits. In addition, we invest excess funds in short-term interest-earning assets, which provide liquidity to meet lending requirements. Additional sources of liquidity for the purpose of managing long- and short-term cash flows include advances from the Federal Home Loan Bank of Chicago.

A portion of our liquidity consists of cash and cash equivalents, which are a product of our operating, investing and financing activities. At December 31, 2012 and 2011, $71.5 million and $80.4 million, respectively, of our assets were invested in cash and cash equivalents. Our primary sources of cash are principal repayments on loans, proceeds from the calls and maturities of debt and mortgage related securities, increases in deposit accounts, Federal funds purchased and advances from the Federal Home Loan Bank of Chicago.

On October 10, 2007, the Federal Home Loan Bank of Chicago entered into a consensual cease and desist order with its regulator, the Federal Housing Finance Board. Under the terms of the order, capital stock repurchases and redemptions, including redemptions upon membership withdrawal or other termination, are prohibited unless the Federal Home Loan Bank of Chicago has received approval of the Director of the Office of Supervision of the Federal Housing Finance Board (the ”OS Director”). The order also provides that dividend declarations are subject to the prior written approval of the OS Director. We currently hold, at cost, $20.2 million of Federal Home Loan Bank of Chicago stock, all of which we believe we will ultimately be able to recover. During 2011, the Federal Home Loan Bank of Chicago received authorization to resume dividend payments to its members and received authorization to initiate an excess stock repurchase plan. Subject to a quarterly assessment of the Federal Home Loan Bank of Chicago’s capacity to repurchase, the stock repurchase plan will allow for the repurchase of member bank’s excess stock that they no longer wish to hold.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included in our Consolidated Financial Statements.

During the years ended December 31, 2012, 2011 and 2010, loan repayments net of loan originations generated positive cash flows of $51.0 million, $42.7 million and $46.6 million, respectively. The decrease in loans receivable is reflective of the general decline in loan demand for variable-rate residential real estate mortgage loans combined with the Company’s tightened underwriting standards given the current economic conditions. Cash received from the calls, maturities and principal repayments of debt and mortgage related securities and structured notes totaled $109.2 million, $93.5 million and $87.8 million for the years ended December 31, 2012, 2011 and 2010, respectively. We purchased $134.9 million, $100.0 million and $101.7 million in debt and mortgage related securities classified as available for sale during the years ended December 31, 2012, 2011 and 2010, respectively. We sold $30.1 million, $3.3 million and $20.7

million in available for sale debt and mortgage related securities during the years ended December 31, 2012, 2011 and 2010, respectively.

Deposit flows are generally affected by the level of interest rates, market conditions and products offered by local competitors and other factors. The net decrease in deposits was $111.8 million during the year ended December 31, 2012. This compares to a net decrease in deposits of $94.2 million for the year ended December 31, 2011 and $19.4 million for the year ended December 31, 2010.

Liquidity management is both a daily and longer-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of Chicago, which provide an additional source of funds. At December 31, 2012, we had $350.0 million in fixed-rate advances from the Federal Home Loan Bank of Chicago, of which none were due within 12 months, but all of which are putable at the option of the Federal Home Loan Bank of Chicago. The weighted average rate on these advances was 3.88% as of December 31, 2012.

At December 31, 2012, we had outstanding commitments to originate loans of $20.8 million and unfunded commitments under construction loans, lines of credit and standby letters of credit of $34.8 million. At December 31, 2012, certificates of deposit scheduled to mature in less than one year totaled $454.6 million. Based on prior experience, management believes that a significant portion of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits are not retained by us, we will have to utilize other funding sources, such as Federal Home Loan Bank of Chicago advances or the Federal Reserve Discount Window to maintain our level of assets. However, such borrowings may not be available on attractive terms, or at all, if and when needed. Alternatively, we would reduce our level of liquid assets, such as our cash and cash equivalents and securities available for sale in order to meet funding needs. In addition, the cost of such deposits may be significantly higher if market interest rates are higher or there is an increased amount of competition for deposits in our market area at the time of renewal.

WaterStone Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning assets and off-balance sheet items to broad risk categories. At December 31, 2012, WaterStone Bank exceeded all regulatory capital requirements and is considered "well capitalized" under regulatory guidelines. See "Supervision and Regulation—Capital Requirements" and note 9 of the notes to the consolidated financial statements.

Contractual Obligations, Commitments, Contingent Liabilities, and Off-balance Sheet Arrangements

WaterStone Bank has various financial obligations, including contractual obligations and commitments that may require future cash payments. The following tables present information indicating various non-deposit contractual obligations and commitments of WaterStone Bank as of December 31, 2012 and the respective maturity dates.

Contractual Obligations

	Total	One Year or Less	More Than One Year Through Three Years	More Than Three Years Through Five Years	Over Five Years
			(In Thousands)		
Deposits without a stated maturity (4)	$ 202,593	202,593	-	-	-
Certificates of deposit (4)	736,920	454,561	251,822	30,517	20
Bank lines of credit (4)	45,888	45,888			
Federal Home Loan Bank advances (1)	350,000	-	-	285,000	65,000
Repurchase agreements (2) (4)	84,000	-	-	84,000	-
Operating leases (3)	3,223	1,664	1,306	253	-
Salary continuation agreements	765	170	340	255	-
Total Contractual Obligations	$ 1,423,389	704,876	253,468	400,025	65,020

(1) Secured under a blanket security agreement on qualifying assets, principally, mortgage loans. Excludes interest that will accrue on the advances. All Federal Home Loan Bank advances are callable on a quarterly basis.
(2) The repurchase agreements are callable on a quarterly basis.
(3) Represents non-cancellable operating leases for offices and equipment.
(4) Excludes interest.

The following table details the amounts and expected maturities of significant off-balance sheet commitments as of December 31, 2012.

Other Commitments

	Total	One Year or Less	More than One Year through Three Years	More than Three Years Through Five Years	Over Five Years
			(In Thousands)		
Real estate loan commitments[1]	$ 20,836	20,836	-	-	-
Unused portion of home equity lines of credit[2]	17,628	17,628	-	-	-
Unused portion of construction loans[3]	5,502	5,502	-	-	-
Unused portion of business lines of credit	10,967	10,967	-	-	-
Standby letters of credit	736	736	-	-	-
Total Other Commitments	$ 55,669	55,669	-	-	-

General: Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract and generally have fixed expiration dates or other termination clauses.
(1) Commitments for loans are extended to customers for up to 180 days after which they expire.
(2) Unused portions of home equity loans are available to the borrower for up to 10 years.
(3) Unused portions of construction loans are available to the borrower for up to 1 year.

Future Accounting Pronouncements

New accounting policies adopted by the Company during 2012 are discussed in Note 1, “Summary of Significant Accounting Policies,” of the notes to consolidated financial statements. The expected impact of accounting policies recently issued or proposed but not yet required to be adopted are discussed below. To the extent the adoption of new accounting standards materially affects the Company’s financial condition, results of operations, or liquidity, the impacts are discussed in the applicable sections of this financial review and the notes to consolidated financial statements.

In December 2011, the Financial Accounting Standards Board (FASB) issued amendments to require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements with certain financial instruments and derivative instruments. The amendments are effective for annual reporting periods beginning on or after January 1, 2013, with retrospective application to the disclosures of all comparative periods presented. The Company will adopt the accounting standard during 2013, as required, and is currently evaluating the impact on its results of operations, financial position, and liquidity.

Impact of Inflation and Changing Prices

The financial statements and accompanying notes of WaterStone Bank have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than do the effects of inflation.

Quarterly Financial Information

The following table sets forth certain unaudited quarterly data for the periods indicated:

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands, except per share data)			
2012 (unaudited)				
Interest income	$ 18,142	$ 17,788	$ 17,274	$ 16,642
Interest expense	7,716	7,160	6,639	6,386
Net interest income	10,426	10,628	10,635	10,256
Provision for loan losses	3,675	1,425	2,000	1,200
Net interest income after provision for loan losses	6,751	9,203	8,635	9,056
Total noninterest income	15,002	23,252	27,775	25,174
Total noninterest expense	19,515	26,236	27,817	28,570
Income before income taxes	2,238	6,219	8,593	5,660
Income taxes (benefit)	30	41	145	(12,420)
Net income	$ 2,208	$ 6,178	$ 8,448	$ 18,080
Income per share – basic	$ 0.07	$ 0.20	$ 0.27	$ 0.58
Income per share - diluted	$ 0.07	$ 0.20	$ 0.27	$ 0.58
2011 (unaudited)				
Interest income	$ 20,337	$ 19,881	$ 19,572	$ 19,562
Interest expense	8,410	8,167	8,094	8,165
Net interest income	11,927	11,714	11,478	11,397
Provision for loan losses	4,875	5,281	6,006	5,915
Net interest income after provision for loan losses	7,052	6,433	5,472	5,482
Total noninterest income	6,797	10,177	13,602	12,653
Total noninterest expense	15,354	17,969	19,216	22,040
Loss before income taxes	(1,505)	(1,359)	(142)	(3,905)
Income taxes (benefit)	39	(775)	64	1,234
Net loss	$ (1,544)	$ (584)	$ (206)	$ (5,139)
Loss per share – basic	$ (0.05)	$ (0.02)	$ (0.01)	$ (0.16)
Loss per share - diluted	$ (0.05)	$ (0.02)	$ (0.01)	$ (0.16)

<u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>

Management of Market Risk

General. The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, WaterStone Bank's board of directors has established an Asset/Liability Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of directors. Management monitors the level of interest rate risk on a regular basis and the Asset/Liability Committee meets at least weekly to review our asset/liability policies and interest rate risk position, which are evaluated quarterly.

We have sought to manage our interest rate risk in order to minimize the exposure of our earnings and capital to changes in interest rates. We have implemented the following strategies to manage our interest rate risk: (i) emphasizing variable rate loans including variable rate one- to four-family, and commercial real estate loans as well as three to five year commercial real estate balloon loans; (ii) reducing and shortening the expected average life of the investment portfolio; and (iii) whenever possible, lengthening the term structure of our deposit base and our borrowings from the FHLBC. These measures should reduce the volatility of our net interest income in different interest rate environments.

Income Simulation. Simulation analysis is an estimate of our interest rate risk exposure at a particular point in time. At least quarterly we review the potential effect changes in interest rates may have on the repayment or repricing of rate sensitive assets and funding requirements of rate sensitive liabilities. Our most recent simulation uses projected repricing of assets and liabilities at December 31, 2012 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rate assumptions may have a significant impact on interest income simulation results. Because of the large percentage of loans and mortgage-backed securities we hold, rising or falling interest rates may have a significant impact on the actual prepayment speeds of our mortgage related assets that may in turn affect our interest rate sensitivity position. When interest rates rise, prepayment speeds slow and the average expected lives of our assets would tend to lengthen more than the expected average lives of our liabilities and therefore would most likely have a negative impact on net interest income and earnings.

	Percentage Increase (Decrease) in Estimated Net Annual Interest Income Over 12 Months
300 basis point gradual rise in rates…………….	1.32%
200 basis point gradual rise in rates…………….	0.26%
100 basis point gradual rise in rates…………….	(0.78%)
Unchanged rate scenario………………………..	(2.21%)
100 basis point gradual decline in rates (1)…….	(4.37%)

(1) Given the current low point in the interest rate cycle, down scenarios in excess of 100 basis points are not meaningful.

WaterStone Bank's Asset/Liability policy limits projected changes in net average annual interest income to a maximum decline of 20% for various levels of interest rate changes measured over a 12-month period when compared to the flat rate scenario. In addition, projected changes in the economic value of equity are limited to a maximum decline of 10% to 80% for interest rate movements of 100 to 300 basis points when compared to the flat rate scenario. These limits are re-evaluated on a periodic basis and may be modified, as appropriate. At December 31, 2012, a 100 basis point gradual increase in interest rates had the effect of reducing forecast net interest income by 0.78% while a 100 basis point decrease in rates had the effect of reducing net interest income by 4.37%. At December 31, 2012, a 100 basis point gradual increase in interest rates had the effect of reducing the economic value of equity by 4.63% while a 100 basis point decrease in rates had the effect of increasing the economic value of equity by 3.30%. While we believe the assumptions used are reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

Board of Directors
Waterstone Financial, Inc.:

We have audited the accompanying consolidated statements of financial condition of Waterstone Financial, Inc. and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012 in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Waterstone Financial, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Milwaukee, Wisconsin
March 15, 2013

Waterstone Financial, Inc. and Subsidiaries
Consolidated Statements of Financial Condition
December 31, 2012 and 2011

		December 31,	
		2012	2011
Assets		(In Thousands, except share data)	
Cash	$	37,129	72,336
Federal funds sold		28,576	8,044
Interest-earning deposits in other financial institutions and other short term investments		5,764	-
Cash and cash equivalents		71,469	80,380
Securities available for sale (at fair value)		205,017	206,519
Securities held to maturity (at amortized cost) fair value of $2,542 in 2011		-	2,648
Loans held for sale (at fair value)		133,613	88,283
Loans receivable		1,133,672	1,216,664
Less: Allowance for loan losses		31,043	32,430
Loans receivable, net		1,102,629	1,184,234
Office properties and equipment, net		26,935	27,356
Federal Home Loan Bank stock (at cost)		20,193	21,653
Cash surrender value of life insurance		38,061	36,749
Real estate owned		35,974	56,670
Prepaid expenses and other assets		27,185	8,359
Total assets	$	1,661,076	1,712,851
Liabilities and Shareholders' Equity			
Liabilities:			
Demand deposits	$	84,140	68,457
Money market and savings deposits		118,453	104,102
Time deposits		736,920	878,733
Total deposits		939,513	1,051,292
Short-term borrowings		45,888	27,138
Long-term borrowings		434,000	434,000
Advance payments by borrowers for taxes		1,672	942
Other liabilities		37,369	33,107
Total liabilities		1,458,442	1,546,479
Shareholders' equity:			
Preferred stock (par value $.01 per share) Authorized - 20,000,000 shares, no shares issued		-	-
Common stock (par value $.01 per share) Authorized - 200,000,000 shares in 2012 and 2011 Issued - 34,072,909 in 2012 and 33,974,450 in 2011 Outstanding - 31,348,556 in 2012 and 31,250,097 in 2011		341	340
Additional paid-in capital		110,490	110,894
Retained earnings		136,487	101,573
Unearned ESOP shares		(1,708)	(2,562)
Accumulated other comprehensive income, net of taxes		2,285	1,388
Treasury shares (2,724,353 shares), at cost		(45,261)	(45,261)
Total shareholders' equity		202,634	166,372
Total liabilities and shareholders' equity	$	1,661,076	1,712,851

See accompanying notes to consolidated financial statements.

Waterstone Financial, Inc. and Subsidiaries
Consolidated Statements of Operations
Years Ended December 31, 2012, 2011 and 2010

	Years ended December 31,		
	2012	2011	2010
	(In Thousands, except per share amounts)		
Interest income:			
Loans	$ 64,317	72,269	81,161
Mortgage-related securities	3,278	3,822	5,360
Debt securities, federal funds sold and			
short-term investments	2,251	3,261	3,412
Total interest income	69,846	79,352	89,933
Interest expense:			
Deposits	9,477	15,289	20,989
Borrowings	18,424	17,547	19,280
Total interest expense	27,901	32,836	40,269
Net interest income	41,945	46,516	49,664
Provision for loan losses	8,300	22,077	25,832
Net interest income after provision for loan losses	33,645	24,439	23,832
Noninterest income:			
Service charges on loans and deposits	1,331	1,078	1,093
Increase in cash surrender value of life insurance	1,071	1,124	1,138
Total other-than-temporary investment losses	(190)	(1,479)	-
Portion of (gain) loss recognized in other comprehensive income (before tax)	(23)	1,023	-
Net impairment losses recognized in earnings	(213)	(456)	-
Mortgage banking income	87,375	39,845	35,465
Gain on sale of available for sale securities	522	53	55
Other	1,117	1,585	1,242
Total noninterest income	91,203	43,229	38,993
Noninterest expenses:			
Compensation, payroll taxes, and other employee benefits	63,507	39,159	36,323
Occupancy, office furniture, and equipment	6,968	6,488	5,762
Advertising	2,647	1,568	1,259
Data processing	1,523	1,400	1,372
Communications	1,277	968	902
Professional fees	2,109	1,648	1,689
Real estate owned	8,746	12,140	6,583
FDIC insurance premiums	3,390	3,814	4,353
Other	11,971	7,394	6,384
Total noninterest expenses	102,138	74,579	64,627
Income (loss) before income taxes	22,710	(6,911)	(1,802)
Income tax expense (benefit)	(12,204)	562	52
Net income (loss)	$ 34,914	(7,473)	(1,854)
Income (loss) per share:			
Basic	$ 1.12	(0.24)	(0.06)
Diluted	$ 1.12	(0.24)	(0.06)
Weighted average shares outstanding:			
Basic	31,054,825	30,929,415	30,804,063
Diluted	31,161,922	30,929,415	30,804,063

See accompanying notes to consolidated financial statements.

Waterstone Financial, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)
Years Ended December 31, 2012, 2011 and 2010

	Years ended December 31,		
	2012	2011	2010
	(In Thousands)		
Net income (loss)	$ 34,914	(7,473)	(1,854)
Other comprehensive income (loss), net of tax:			
Net unrealized holding gain (loss) on avaliable for sale securities arising during the period, net of tax (expense) benefit of ($791), ($1,240) and ($2,102) respectively	1,082	(201)	3,592
Reclassification adjustment for net gain (loss) on available for sale securities realized during the period, net of tax expense (benefit) of $124, ($22) and $22, respectively	(185)	31	(33)
Total other comprehensive income (loss)	897	(170)	3,559
Comprehensive income (loss)	$ 35,811	(7,643)	1,705

See accompanying notes to consolidated financial statements.

Waterstone Financial, Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2012, 2011 and 2010

	Common Stock		Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Treasury Shares	Total Shareholders' Equity
	Shares	Amount						
	(In Thousands)							
Balances at December 31, 2009	31,250	340	108,883	110,900	(4,269)	(2,001)	(45,261)	168,592
Comprehensive income (loss):								
Net loss	—	—	—	(1,854)	—	—	—	(1,854)
Other comprehensive income	—	—	—	—	—	3,559	—	3,559
Total comprehensive loss								1,705
ESOP shares committed to be released to Plan participants	—	—	(589)	—	853	—	—	264
Stock based compensation	—	—	1,659	—	—	—	—	1,659
Balances at December 31, 2010	31,250	$ 340	109,953	109,046	(3,416)	1,558	(45,261)	172,220
Comprehensive income (loss):								
Net loss	—	—	—	(7,473)	—	—	—	(7,473)
Other comprehensive loss:	—	—	—	—	—	(170)	—	(170)
Total comprehensive loss								(7,643)
ESOP shares committed to be released to Plan participants	—	—	(652)	—	854	—	—	202
Stock based compensation	—	—	1,593	—	—	—	—	1,593
Balances at December 31, 2011	31,250	$ 340	110,894	101,573	(2,562)	1,388	(45,261)	166,372
Comprehensive income:								
Net income	—	—	—	34,914	—	—	—	34,914
Other comprehensive income:	—	—	—	—	—	897	—	897
Total comprehensive income								35,811
ESOP shares committed to be released to Plan participants	—	—	(548)	—	854	—	—	306
Stock based compensation	98	1	144	—	—	—	—	145
Balances at December 31, 2012	31,348	$ 341	110,490	136,487	(1,708)	2,285	(45,261)	202,634

See accompanying notes to consolidated financial statements.

Waterstone Financial, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2012, 2011 and 2010

		Years ended December 31,		
		2012	2011	2010
			(In Thousands)	
Operating activities:				
Net income (loss)	$	34,914	(7,473)	(1,854)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Provision for loan losses		8,300	22,077	25,832
Provision for depreciation		2,081	1,842	1,859
Deferred income taxes		(16,895)	(735)	-
Stock based compensation		145	1,593	1,659
Net amortization of premium/discount on debt and mortgage related securities		1,647	635	70
Amortization of unearned ESOP shares		306	202	264
Gain on sale of loans held for sale		(90,171)	(37,667)	(35,465)
Loans originated for sale		(1,749,426)	(1,027,346)	(1,084,362)
Proceeds on sales of loans originated for sale		1,794,268	1,072,863	1,068,746
Decrease in accrued interest receivable		612	37	424
Increase in cash surrender value of life insurance		(1,071)	(1,124)	(1,138)
Decrease in accrued interest on deposits and borrowings		(372)	(239)	(1,011)
Increase in other liabilities		4,796	211	7,565
Increase (decrease) in accrued tax payable		(161)	1,282	5,606
Gain on sale of available for sale securities		(522)	(53)	(55)
Impairment of securities		213	456	-
Net realized and unrealized loss related to real estate owned		6,162	6,052	675
Other		(2,963)	2,477	(1,943)
Net cash (used in) provided by operating activities		(8,137)	35,090	(13,128)
Investing activities:				
Net decrease in loans receivable		51,023	42,692	46,642
Purchases of:				
Debt securities		(19,269)	(85,802)	(66,955)
Mortgage related securities		(115,660)	(14,184)	(34,700)
Premises and equipment, net		(1,674)	(1,021)	(925)
Bank owned life insurance		(240)	(240)	(306)
Proceeds from:				
Principal repayments on mortgage-related securities		35,504	31,433	40,624
Maturities of debt securities		71,065	62,115	47,202
Sales of debt securities		11,798	—	14,023
Sales of mortgage-related securities		18,291	3,230	6,710
Calls of structured notes		2,648	—	—
Sales of foreclosed properties and other assets		36,580	23,231	33,577
Redemption of FHLB stock		1,459	—	—
Net cash provided by investing activities		91,525	61,454	85,892

See Accompanying notes to consolidated financial statements.

Waterstone Financial, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2012, 2011 and 2010

	Years ended December 31,		
	2012	2011	2010
	(In Thousands)		
Financing activities:			
Net decrease in deposits	(111,779)	(94,237)	(19,361)
Net increase (decrease) in short-term borrowings	18,750	4,179	(50,941)
Net increase (decrease) in advance payments by borrowers for taxes	730	(1,437)	1,749
Net cash used by financing activities	(92,299)	(91,495)	(68,553)
(Decrease) increase in cash and cash equivalents	(8,911)	5,049	4,211
Cash and cash equivalents at beginning of year	80,380	75,331	71,120
Cash and cash equivalents at end of year	$ 71,469	80,380	75,331
Supplemental information:			
Cash paid, credited or (received) during the period for:			
Income tax payments (refunds)	4,852	69	(5,554)
Interest payments	28,273	33,076	41,013
Noncash investing activities:			
Loans receivable transferred to other real estate	22,282	28,259	41,781

See Accompanying notes to consolidated financial statements.

1) Summary of Significant Accounting Policies

a) Organization

The board of directors of WaterStone Bank (the Bank) adopted the Plan of Reorganization and related Stock Issuance Plan on May 17, 2005, as amended on June 3, 2005, under which Waterstone Financial, Inc. (the Company) was formed to become the mid-tier holding company for the Bank. In addition, Lamplighter Financial, MHC, a Federally-chartered mutual holding company, was formed to become the majority owner of Waterstone Financial, Inc. The Company's outstanding common shares are 73.5% owned by Lamplighter Financial, MHC at December 31, 2012.

b) Nature of Operations

The Company is a one-bank holding company with two operating segments – community banking and mortgage banking. The Bank is principally engaged in the business of attracting deposits from the general public and using such deposits to originate real estate, business and consumer loans.

The Bank provides a full range of financial services to customers through branch locations in southeastern Wisconsin. The Bank is subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

The Bank owns a mortgage banking subsidiary that originates residential real estate loans held for sale at various branch offices across the country. Mortgage banking volume fluctuates widely given movements in interest rates. Mortgage banking income is reported as a single line item in the statements of operations while mortgage banking expense is distributed among the various noninterest expense lines. Compensation, payroll taxes and other employee benefits expense varies directly with mortgage banking income.

c) Principles of Consolidation

The consolidated financial statements include the accounts and operations of Waterstone Financial, Inc. and its wholly owned subsidiary, WaterStone Bank. The Bank has the following wholly owned subsidiaries: Wauwatosa Investments, Inc. and Waterstone Mortgage Corporation. All significant intercompany accounts and transactions have been eliminated in consolidation.

d) Use of Estimates

The preparation of the consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include: the allowance for loan losses, deferred income taxes, valuation of investments, evaluation of other than temporary impairment on investments and valuation of real estate owned. Actual results could differ from those estimates and the current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

e) Cash and Cash Equivalents

The Company considers federal funds sold and highly liquid debt instruments with a maturity of three months or less when purchased to be cash equivalents.

f) Securities

Available for Sale Securities

At the time of purchase, investment securities are classified as available for sale, as management has the intent and ability to hold such securities for an indefinite period of time, but not necessarily to maturity. Any decision to sell investment securities available for sale would be based on various factors, including, but not limited to asset/liability management strategies, changes in interest rates or prepayment risks, liquidity needs, or regulatory capital considerations. Available for sale securities are carried at fair value, with the unrealized gains and losses, net of deferred tax, reported as a separate component of equity, accumulated other comprehensive income. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity or, in the case of mortgage-backed securities and collateralized mortgage obligations, over the estimated life of the security. Such amortization is included in interest income from securities. Realized gains or losses on securities sales (using specific identification method) are included in other income. Declines in value judged to be other than temporary are included in net impairment losses recognized in earnings in the consolidated statements of operations.

Held to Maturity Securities

Debt securities that the Company has the intent and ability to hold to maturity have been designated as held to maturity. Such securities are stated at amortized cost.

Other Than Temporary Impairment

One of the significant estimates related to securities is the evaluation of investments for other than temporary impairment. The Company assesses investment securities with unrealized loss positions for other than temporary impairment on at least a quarterly basis. When the fair value of an investment is less than its amortized cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is designated as either temporary or other than temporary. In evaluating other than temporary impairment, management considers the length of time and extent to which the fair value has been less than cost and the expected recovery period of the security, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. Declines in the fair value of investment securities below amortized cost are deemed to be other than temporary when the Company cannot assert that it will recover its amortized cost basis, including whether the present value of cash flows expected to be collected is less than the amortized cost basis of the security. If it is more likely than not that the Company will be required to sell the security before recovery or if the Company has the intent to sell, an other than temporary impairment write down is recognized in earnings equal to the difference between the security's amortized cost and its fair value. If it is not more likely than not that the Company will be required to sell the security before recovery and if the Company does not intend to sell, the other than temporary impairment write down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to other factors, which is recognized as a separate component of equity. Following the recognition of an other than temporary impairment representing credit loss, the book value of an investment less the impairment loss realized becomes the new cost basis. Because the Company's assessments are based on factual information as well as subjective information available at the time of assessment, the determination as to whether an other than temporary impairment exists and, if so, the amount considered other than temporarily impaired, or not impaired, is subjective and, therefore, the timing and amount of other than temporary impairments constitute material estimates that are subjective to significant change.

Federal Home Loan Bank Stock

Federal Home Loan Bank stock is carried at cost, which is the amount that the stock is redeemable by tendering to the FHLBC or the amount at which shares can be sold to other FHLBC members. FHLBC dividends are recognized as income on their ex-dividend date.

g) Loans Held for Sale

The origination of residential real estate loans is an integral component of the business of the Company. The Company generally sells its originations of long-term fixed interest rate mortgage loans in the secondary market. Gains and losses on the sales of these loans are determined using the specific identification method. The Company generally sells mortgage loans in the secondary market on a servicing released basis, however, servicing is retained when economic conditions so warrant. Mortgage loans originated for sale are generally sold within 45 days after closing.

The Company has elected to carry loans held for sale at fair value. Fair value is generally determined by estimating a gross premium or discount, which is derived from pricing currently observable in the market. The amount by which cost differs from market value is accounted for as a valuation adjustment to the carrying value of the loans. Changes in value are included in mortgage banking income in the consolidated statements of operations. The carrying value of loans held for sale included a market valuation adjustment of $6.0 million at December 31, 2012 and $3.2 million at December 31, 2011.

Costs to originate loans held for sale are expensed as incurred and are included on the appropriate noninterest expense lines of the statements of operations. Salaries, commissions and related payroll taxes are the primary costs to originate and comprise approximately 73% of total mortgage banking noninterest expense.

The value of mortgage loans held for sale and other residential mortgage loan commitments to customers are hedged by utilizing both best efforts and mandatory forward commitments to sell loans to investors in the secondary market. Such forward commitments are generally entered into at the time when applications are taken to protect the value of the mortgage loans from increases in market interest rates during the period held. The Corporation recognizes revenue associated with the expected future cash flows of servicing loans at the time a forward loan commitment is made, as required under Securities and Exchange Commission Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value Through Earnings.

h) Loans Receivable and Related Interest Income

Loans are classified as held for investment when management has both the intent and ability to hold the loan for the foreseeable future, or until maturity or payoff. Loans are carried at the principal amount outstanding, net of any unearned income, charge-offs and unamortized deferred fees and costs. Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of the related loan yield. Amortization is based on a level-yield method over the contractual life of the related loans or until the loan is paid in full.

Loan interest income is recognized on the accrual basis. Accrual of interest is generally discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal, or when a loan becomes contractually past due more than 90 days with respect to interest or principal. At that time, previously accrued and uncollected interest on such loans is reversed and additional income is recorded only to the extent that payments are received and the collection of principal is reasonably assured. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

A loan is accounted for as a troubled debt restructuring if the Company, for economic reasons related to the borrower's financial condition, grants a concession to the borrower that it would not otherwise consider. A troubled debt restructuring typically involves a modification of terms such as a reduction of the stated interest rate, a deferral of principal payments or a combination of both for a temporary period of time. If the borrower was performing in accordance with the original contractual terms at the time of the restructuring, the restructured loan is accounted for on an accruing basis as long as the borrower continues to comply with the modified terms. If the loan was not accounted for on an accrual basis at the time of restructuring, the restructured loan remains in non-accrual status until the loan returns to its original contractual terms and a positive payment history is established.

i) Allowance for Loan Losses

The allowance for loan losses is presented as a reserve against loans and represents the Bank's assessment of probable loan losses inherent in the loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Estimated loan losses are charged against the allowance when the loan balance is confirmed to be uncollectible directly or indirectly by the borrower or upon initiation of a foreclosure action by the Bank. Subsequent recoveries, if any, are credited to the allowance.

The allowance provides for probable losses that have been identified with specific customer relationships and for probable losses believed to be inherent in the loan portfolio, but have not been specifically identified. The Bank utilizes its own loss history to estimate inherent losses on loans. Although the Bank allocates portions of the allowance to specific loans and loan types, the entire allowance is available for any loan losses that occur.

The Bank evaluates the need for specific valuation allowances on loans that are considered impaired. A loan is considered impaired when, based on current information and events, it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Within the loan portfolio, all non-accrual loans and loans modified under troubled debt restructurings have been determined by the Bank to meet the definition of an impaired loan. In addition, other one- to four-family, over four-family, construction and land, commercial real estate and commercial loans may be considered impaired loans. A valuation allowance is established for an amount equal to the impairment when the carrying amount of the loan exceeds the present value of the expected future cash flows, discounted at the loan's original effective interest rate or the fair value of the underlying collateral.

The Bank also establishes valuation allowances based on an evaluation of the various risk components that are inherent in the loan portfolio. The risk components that are evaluated include past loan loss experience; the level of non-performing and classified assets; current economic conditions; volume, growth, and composition of the loan portfolio; adverse situations that may affect the borrower's ability to repay; the estimated value of any underlying collateral; regulatory guidance; and other relevant factors.

The appropriateness of the allowance for loan losses is approved quarterly by the Bank's board of directors. The allowance reflects management's best estimate of the amount needed to provide for the probable loss on impaired loans, as well as other credit risks of the Bank, and is based on a risk model developed and implemented by management and approved by the Bank's board of directors.

Actual results could differ from this estimate, and future additions to the allowance may be necessary based on unforeseen changes in economic conditions. In addition, federal regulators periodically review the Bank's allowance for loan losses. Such regulators have the authority to require the Bank to recognize additions to the allowance at the time of their examination.

j) Real Estate Owned

Real estate owned consists of properties acquired through, or in lieu of, loan foreclosure. Real estate owned is transferred into the portfolio at the lower of estimated fair value less anticipated selling costs based upon the property's appraised value at the date of transfer or the net carrying value of the loan. To the extent that the net carrying value of the loan exceeds the estimated fair value of the property at the date of transfer, the excess is charged to the allowance for loan losses. Subsequent write-downs to reflect current fair market value, as well as gains and losses upon disposition and revenue and expenses incurred in maintaining such properties, are treated as period costs and included in real estate owned in the consolidated statements of operations.

k) Mortgage Servicing Rights

The Company sells residential mortgage loans in the secondary market and, on a selective basis, retains the right to service the loans sold. Upon sale, a mortgage servicing rights asset is capitalized, which represents the then current fair value of future net cash flows expected to be realized for performing servicing activities. Mortgage servicing rights, when purchased, are initially recorded at fair value. Mortgage servicing rights are amortized over the period of estimated net servicing income, and assessed for impairment at each reporting date. Mortgage servicing rights are carried at the lower of the initial capitalized amount, net of accumulated amortization, or estimated fair value, and are included in other assets, net in the consolidated balance sheets.

l) Cash Surrender Value of Life Insurance

The Company purchased bank owned life insurance on the lives of certain employees. The Company is the beneficiary of the life insurance policies. The cash surrender value of life insurance is reported at the amount that would be received in cash if the polices were surrendered. Increases in the cash value of the policies and proceeds of death benefits received are recorded in non-interest income. The increase in cash surrender value of life insurance is not subject to income taxes, as long as the Company has the intent and ability to hold the policies until the death benefits are received.

m) Office Properties and Equipment

Office properties and equipment, including leasehold improvements and software, are stated at cost, net of depreciation and amortization. Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the lease term, if shorter than the estimated useful life. Maintenance and repairs are charged to expense as incurred, while additions or major improvements are capitalized and depreciated over their estimated useful lives. Estimated useful lives of the assets are 10 to 30 years for office properties, three to 10 years for equipment, and three years for software. Rent expense related to long-term operating leases is recorded on the accrual basis.

n) Income Taxes

The Company and its subsidiaries file consolidated federal and combined state income tax returns. The provision for income taxes is based upon income in the consolidated financial statements, rather than amounts reported on the income tax returns. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as net operating loss carry fowards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

The Company evaluates the realizability of its deferred tax assets on a quarterly basis. Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is "more likely than not" that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, the forecasts of future income, applicable tax planning strategies, and assessments of current and future economic and business conditions.

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. The benefit of uncertain tax positions are initially recognized in the financial statements only when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. Interest and penalties on income tax uncertainties are classified within income tax expense in the income statement.

o) Earnings Per Share

Earnings per share are computed using the two-class method. Basic earnings per share is computed by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding adjusted for the dilutive effect of all potential common shares. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Shares of the Employee Stock Ownership Plan committed to be released are considered outstanding for both common and diluted EPS. Incentive stock compensation awards granted can result in dilution.

p) Comprehensive Income

Comprehensive income is the total of reported net income and changes in unrealized gains or losses, net of tax, on securities available for sale.

q) Employee Stock Ownership Plan (ESOP)

Compensation expense under the ESOP is equal to the fair value of common shares released or committed to be released to participants in the ESOP in each respective period. Common stock purchased by the ESOP and not committed to be released to participants is included in the consolidated statements of financial condition at cost as a reduction of shareholders' equity.

r) Impact of Recent Accounting Pronouncements

In June 2011, the FASB issued guidance to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The amendments require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments were effective for interim and annual periods beginning after December 15, 2011 with retrospective application. Subsequently, in December 2011, the FASB decided that the requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income will be deferred. Therefore, those requirements will not be effective for public entities for fiscal years and interim periods within those years beginning after December 15, 2011. The adoption of this accounting standard did not have a material impact on the Company's results of operations, financial position, and liquidity. See the Consolidated Statement of Comprehensive Income (Loss) for required disclosures.

In May 2011, the FASB issued guidance on measuring fair value to create common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. The amendments change the wording used to describe many of the requirements for measuring fair value and for disclosing information about fair value measurements. The amendments also clarify the Board's intent about the application of existing fair value measurement and disclosure requirements. The amendments were effective for interim and annual periods beginning after December 15, 2011. The adoption of this accounting standard did not have a material impact on the Company's results of operations, financial position, and liquidity. See Note 16 for required disclosures on fair value measurements.

2) Securities

Securities Available for Sale

The amortized cost and fair values of the Company's investment in securities follow:

	December 31, 2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$ 116,813	2,349	(106)	119,056
Collateralized mortgage obligations				
Government sponsored enterprise issued	29,207	373	(1)	29,579
Mortgage related securities	146,020	2,722	(107)	148,635
Government sponsored enterprise bonds	8,000	17	—	8,017
Municipal securities	35,493	2,043	(165)	37,371
Other debt securities	5,000	70	—	5,070
Debt securities	48,493	2,130	(165)	50,458
Certificates of Deposit	5,880	45	(1)	5,924
	$ 200,393	4,897	(273)	205,017

	December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	$ 33,561	1,857	(1)	35,417
Collateralized mortgage obligations				
Government sponsored enterprise issued	32,650	559	(13)	33,196
Private label issued	19,475	16	(1,040)	18,451
Mortgage related securities	85,686	2,432	(1,054)	87,064
Government sponsored enterprise bonds	71,210	152	(13)	71,349
Municipal securities	37,644	1,744	(320)	39,068
Other debt securities	5,000	118	—	5,118
Debt securities	113,854	2,014	(333)	115,535
Certificates of Deposit	3,920	2	(2)	3,920
	$ 203,460	4,448	(1,389)	206,519

The Company's mortgage-backed securities and collateralized mortgage obligations issued by government sponsored enterprises are guaranteed by one of the following government sponsored enterprises: Fannie Mae, Freddie Mac or Ginnie Mae. At December 31, 2012, $6.1 million of the Company's government sponsored enterprise bonds and $95.8 million of the Company's mortgage related securities were pledged as collateral to secure repurchase agreement obligations of the

Company. As of December 31, 2012, $8.0 million of municipal securities were pledged as collateral to secure Federal Home Loan Bank advances.

The amortized cost and fair value of securities at December 31, 2012, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because issuers or borrowers may have the right to prepay obligations with or without prepayment penalties.

	December 31, 2012		
		Amortized cost	Fair value
		(In Thousands)	
Debt securities:			
Due within one year	$	2,925	2,932
Due after one year through five years		22,354	23,376
Due after five years through ten years		10,239	10,288
Due after ten years		18,855	19,786
Mortgage-related securities		146,020	148,635
	$	200,393	205,017

Total proceeds and gross gains and losses from sales of investment securities available for sale for each of periods listed below.

		December 31,		
		2012	2011	2010
		(In Thousands)		
Gross gains	$	522	53	136
Gross losses		-	-	(81)
Gains on sale of investment securities, net	$	522	53	55
Proceeds from sales of investment securities	$	30,089	3,230	20,733

Gross unrealized losses on securities available for sale and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows:

	December 31, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(In Thousands)					
Mortgage-backed securities	19,382	(106)	—	—	19,382	(106)
Collateralized mortgage obligations						
Government sponsored enterprise issued	1,419	(1)	—	—	1,419	(1)
Municipal securities	9,009	(94)	398	(71)	9,407	(165)
Certificates of Deposit	244	(1)	—	—	244	(1)
	$ 30,054	(202)	398	(71)	30,452	(273)

	December 31, 2011					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
	(In Thousands)					
Mortgage-backed securities	1,167	(1)	—	—	1,167	(1)
Collateralized mortgage obligations						
Government sponsored enterprise issued	5,726	(13)	—	—	5,726	(13)
Private-label issue	—	—	15,408	(1,040)	15,408	(1,040)
Government sponsored enterprise bonds	12,487	(13)	—	—	12,487	(13)
Municipal securities	228	(87)	1,989	(233)	2,217	(320)
Certificates of Deposit	1,958	(2)	—	—	1,958	(2)
	$ 21,566	(116)	17,397	(1,273)	38,963	(1,389)

The Company reviews the investment securities portfolio on a quarterly basis to monitor its exposure to other-than-temporary impairment. In evaluating whether a security's decline in market value is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, financial condition of the issuer and the underlying obligors, quality of credit enhancements, volatility of the fair value of the security, the expected recovery period of the security and ratings agency evaluations. In addition the Company may also evaluate payment structure, whether there are defaulted payments or expected defaults, prepayment speeds and the value of any underlying collateral. For certain securities in unrealized loss positions, the Company prepares cash flow analyses to compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security.

During the year ended December 31, 2012, the Company identified two private-label collateralized mortgage obligation securities for which a cash flow analysis was performed to determine whether an other-than-temporary impairment was warranted. This evaluation indicated that the two private-label collateralized mortgage obligations were other-than-temporarily impaired. Estimates of discounted cash flows based on expected yield at time of original purchase, prepayment assumptions based on actual and anticipated prepayment speed, actual and anticipated default rates and estimated level of severity given the loan to value ratios, credit scores, geographic locations, vintage and levels of subordination related to the security and its underlying collateral resulted in a projected credit loss on the collateralized mortgage obligations. During the year ended December 31, 2012, the Company's analysis resulted in an additional $113,000 in credit losses that were charged to earnings with respect to one of these two collateralized mortgage obligations. The analysis with respect to the second collateralized mortgage obligation indicated no additional estimated credit loss for the year ended December 31, 2012. During the year ended December 31, 2012, the two aforementioned private-label collateralized mortgage obligations were sold at a combined gain of $282,000. At the time of sale, these securities had a combined amortized cost of $18.0 million.

In addition to the securities discussed above, during the year ended December 31, 2012, the Company identified two municipal securities that were deemed to be other-than-temporarily impaired. Both securities were issued by a tax incremental district in a municipality located in Wisconsin. During the year ended December 31, 2012, the Company received audited financial statements with respect to the municipal issuer that called into question the ability of the underlying taxing district that issued the securities to operate as a going concern. During the year ended December 31, 2012, the Company's analysis of these securities resulted in $100,000 in credit losses that were charged to earnings with respect to these two municipal securities. As of December 31, 2012, these securities had a combined amortized cost of $215,000 and a combined estimated fair value of $237,000. As of December 31, 2012, the Company had one municipal security which had been in an unrealized loss position for twelve months or longer. This security was determined not to be other-than-temporarily impaired as of December 31, 2012.

The following table presents the change in other-than-temporary credit related impairment charges on collateralized mortgage obligations and municipal securities for which a portion of the other-than-temporary impairments related to other factors was recognized in other comprehensive loss.

	(in thousands)
Credit related impairments on securities as of December 31, 2010	$ 1,640
Credit related impairments related to a security for which other-than-temporary impairment was not previously recognized	-
Increase in credit related impairments related to securities for which an other-than-temporary impairment was previously recognized	456
Credit related impairments on securities as of December 31, 2011	2,096
Credit related impairments related to a security for which other-than-temporary impairment was not previously recognized	100
Increase in credit related impairments related to securities for which an other-than-temporary impairment was previously recognized	113
Reduction for sales of securities for which other-than-temporary impairment was previously recognized	(2,209)
Credit related impairments on securities as of December 31, 2012	$ 100

Exclusive of the two aforementioned municipal securities, the Company has determined that the decline in fair value of the remaining securities is not attributable to credit deterioration, and as the Company does not intend to sell nor is it more likely than not that it will be required to sell these securities before recovery of the amortized cost basis, these securities are not considered other-than-temporarily impaired.

Continued deterioration of general economic market conditions could result in the recognition of future other than temporary impairment losses within the investment portfolio and such amounts could be material to our consolidated financial statements.

Securities Held to Maturity

As of December 31, 2012, the Company does not hold any securities that are designated as held to maturity. During the year ended December 31, 2012, the one security held by the Company that had been designated as held to maturity was called by the issuer. This security had an amortized cost of $2.6 million at the time that it was called.

3) Loans Receivable

Loans receivable at December 31, 2012 and 2011 are summarized as follows:

	December 31,	
	2012	**2011**
Mortgage loans:	**(In Thousands)**	
Residential real estate:		
One- to four-family	$ 460,821	496,736
Over four-family	514,363	552,240
Home equity	36,494	38,599
Construction and land	33,818	39,528
Commercial real estate	65,495	65,434
Consumer	132	109
Commercial loans	22,549	24,018
Total loans receivable	$ 1,133,672	1,216,664

The Company provides several types of loans to its customers, including residential, construction, commercial and consumer loans. Significant loan concentrations are considered to exist for a financial institution when there are amounts loaned to one borrower or to multiple borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. While credit risks tend to be geographically concentrated in the Company's Milwaukee metropolitan area and while 89.2% of the Company's loan portfolio involves loans that are secured by residential real estate, there are no concentrations with individual or groups of related borrowers. While the real estate collateralizing these loans is primarily residential in nature, it ranges from owner-occupied single family homes to large apartment complexes. In addition, real estate collateralizing $81.1 million or 7.2% of total mortgage loans is located outside of the state of Wisconsin.

During the year ended December 31, 2012, $1.75 billion in residential loans were originated for sale. During the same period, sales of loans held for sale totaled $1.70 billion, generating mortgage banking income of $87.4 million. During the year ended December 31, 2011, the Company began selectively selling loans on a servicing retained basis. The unpaid principal balance of loans serviced for others was $635.8 million and $29.9 million at December 31, 2012 and December 31, 2011, respectively. These loans are not reflected in the consolidated statements of financial condition.

Qualifying loans receivable totaling $801.6 million and $715.7 million are pledged as collateral against $350.0 million in outstanding Federal Home Loan Bank of Chicago advances under a blanket security agreement at both December 31, 2012 and December 31, 2011.

An analysis of past due loans receivable as of December 31, 2012 and 2011 follows:

	As of December 31, 2012					
	1-59 Days Past Due (1)	**60-89 Days Past Due (2)**	**Greater Than 90 Days**	**Total Past Due**	**Current (3)**	**Total Loans**
Mortgage loans:			(In Thousands)			
Residential real estate:						
One- to four-family	$ 11,745	5,402	29,259	46,406	414,415	460,821
Over four-family	3,543	1,498	18,336	23,377	490,986	514,363
Home equity	416	111	404	931	35,563	36,494
Construction and land	87	-	2,180	2,266	31,552	33,818
Commercial real estate	290	-	668	959	64,536	65,495
Consumer	-	-	-	-	132	132
Commercial loans	-	-	511	511	22,038	22,549
Total	$ 16,081	7,011	51,358	74,450	1,059,222	1,133,672

	As of December 31, 2011					
	1-59 Days Past Due (1)	**60-89 Days Past Due (2)**	**Greater Than 90 Days**	**Total Past Due**	**Current (3)**	**Total Loans**
Mortgage loans:			(In Thousands)			
Residential real estate:						
One- to four-family	$ 12,650	5,536	40,001	58,187	438,549	496,736
Over four-family	13,044	2,630	8,946	24,620	527,620	552,240
Home equity	1,982	131	290	2,403	36,196	38,599
Construction and land	49	155	6,790	6,994	32,534	39,528
Commercial real estate	70	-	515	585	64,849	65,434
Consumer	8	-	-	8	101	109
Commercial loans	543	-	70	613	23,405	24,018
Total	$ 28,346	8,452	56,612	93,410	1,123,254	1,216,664

(1) Includes $2.4 million and $4.6 million for December 31, 2012 and 2011, respectively, which are on non-accrual status.
(2) Includes $2.8 million and $1.4 million for December 31, 2012 and 2011, respectively, which are on non-accrual status.
(3) Includes $18.2 million and $15.7 million for December 31, 2012 and 2011, respectively, which are on non-accrual status.

As of December 31, 2012 and 2011, there are no loans that are 90 or more days past due and still accruing interest.

A summary of the activity for the years ended December 31, 2012, 2011 and 2010 in the allowance for loan losses follows:

		One- to Four- Family	Over Four Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
		(In Thousands)							
Year ended December 31, 2012									
Balance at beginning of period	$	17,475	8,252	1,998	2,922	941	28	814	32,430
Provision for loan losses		6,149	534	559	(181)	1,500	6	(267)	8,300
Charge-offs		(6,472)	(1,108)	(485)	(1,668)	(1,182)	(4)	(59)	(10,978)
Recoveries		667	56	25	250	-	-	293	1,291
Balance at end of period	$	17,819	7,734	2,097	1,323	1,259	30	781	31,043
Year ended December 31, 2011									
Balance at beginning of period	$	16,150	6,877	1,196	3,252	671	28	1,001	29,175
Provision for loan losses		12,567	5,331	1,429	1,346	998	9	397	22,077
Charge-offs		(11,553)	(3,996)	(634)	(1,745)	(734)	(10)	(619)	(19,291)
Recoveries		311	40	7	69	6	1	35	469
Balance at end of period	$	17,475	8,252	1,998	2,922	941	28	814	32,430
Year ended December 31, 2010									
Balance at beginning of period	$	17,875	5,208	1,642	2,635	720	43	371	28,494
Provision for loan losses		15,054	5,053	170	2,934	525	(3)	2,099	25,832
Charge-offs		(16,906)	(3,439)	(619)	(2,319)	(575)	(13)	(1,470)	(25,341)
Recoveries		127	55	3	2	1	1	1	190
Balance at end of period	$	16,150	6,877	1,196	3,252	671	28	1,001	29,175

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of the year ended December 31, 2012 follows:

	One- to Four-Family	Over Four Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
Allowance related to loans individually evaluated for impairment	$ 7,058	3,268	1,033	377	341	-	331	12,408
Allowance related to loans collectively evaluated for impairment	10,761	4,466	1,064	946	918	30	450	18,635
Balance at end of period	$ 17,819	7,734	2,097	1,323	1,259	30	781	31,043
Loans individually evaluated for impairment	$ 57,467	28,281	2,127	4,470	1,250	24	1,352	94,971
Loans collectively evaluated for impairment	403,354	486,082	34,367	29,348	64,245	108	21,197	1,038,701
Total gross loans	$ 460,821	514,363	36,494	33,818	65,495	132	22,549	1,133,672

Waterstone Financial, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
Years Ended December 31, 2012, 2011 and 2010

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of the year ended December 31, 2011 follows:

	One- to Four-Family	Over Four Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
	(In Thousands)							
Allowance related to loans individually evaluated for impairment	$ 5,707	3,719	803	2,077	-	-	269	12,575
Allowance related to loans collectively evaluated for impairment	11,768	4,533	1,195	845	941	28	545	19,855
Balance at end of period	$ 17,475	8,252	1,998	2,922	941	28	814	32,430
Loans individually evaluated for impairment	$ 68,321	40,783	2,227	8,436	515	-	1,115	121,397
Loans collectively evaluated for impairment	428,415	511,457	36,372	31,092	64,919	109	22,903	1,095,267
Total gross loans	$ 496,736	552,240	38,599	39,528	65,434	109	24,018	1,216,664

The following table presents information relating to the Company's internal risk ratings of its loans receivable as of December 31, 2012 and 2011:

	One- to Four-Family	Over Four Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
At December 31, 2012	(In Thousands)							
Substandard	$ 53,242	24,767	2,913	3,705	1,251	23	1,365	87,266
Watch	17,082	14,157	606	2,803	1,234	-	964	36,846
Pass	390,497	475,439	32,975	27,310	63,010	109	20,220	1,009,560
	$ 460,821	514,363	36,494	33,818	65,495	132	22,549	1,133,672
At December 31, 2011	(In Thousands)							
Substandard	$ 68,566	37,502	3,188	8,436	1,114	-	1,116	119,922
Watch	14,341	16,993	721	6,199	1,549	-	1,108	40,911
Pass	413,829	497,745	34,690	24,893	62,771	109	21,794	1,055,831
	$ 496,736	552,240	38,599	39,528	65,434	109	24,018	1,216,664

Factors that are important to managing overall credit quality include sound loan underwriting and administration, systematic monitoring of existing loans and commitments, effective loan review on an ongoing basis, early identification of potential problems, an allowance for loan losses, and sound non-accrual and charge-off policies. Our underwriting policies require an officers' loan committee review and approval of all loans in excess of $500,000. In addition, an independent loan review function exists for all loans. Our ability to manage credit risk depends in large part on our ability to properly identify and manage problem loans. To do so, we maintain a loan review system under which our credit management personnel review non-owner occupied one- to four-family, over four-family, construction and land, commercial real estate and commercial loans that individually, or as part of an overall borrower relationship exceed $1.0 million in potential exposure. Loans meeting these criteria are reviewed on an annual basis, or more frequently, if the loan renewal is less than one year. With respect to this review process, management has determined that pass loans include loans that exhibit acceptable financial statements, cash flow and leverage. Watch loans have potential weaknesses that deserve management's attention, and if left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the credit. Substandard loans are considered inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged. These loans generally have a well-defined weakness that may jeopardize liquidation of the debt and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Finally, a loan is considered to be impaired when it is probable that the Bank will not be able to collect all amounts due according to the contractual terms of the loan agreement. Management has determined that all non-accrual loans and loans modified under troubled debt restructurings meet the definition of an impaired loan.

The Company's procedures dictate that an updated valuation must be obtained with respect to underlying collateral at the time a loan is deemed impaired. Updated valuations may also be obtained upon transfer from loans receivable to real estate owned based upon the age of the prior appraisal, changes in market conditions or known changes to the physical condition of the property.

Estimated fair values are reduced to account for sales commissions, broker fees, unpaid property taxes and additional selling expenses to arrive at an estimated net realizable value. The adjustment factor is based upon the Company's actual experience with respect to sales of real estate owned over the prior two years. In situations in which we are placing reliance on an appraisal that is more than one year old, an additional adjustment factor is applied to account for downward market pressure since the date of appraisal. The additional adjustment factor is based upon relevant sales data available for our general operating market as well as company-specific historical net realizable values as compared to the most recent appraisal prior to disposition.

With respect to over-four family income producing real estate, appraisals are reviewed and estimated collateral values are adjusted by updating significant appraisal assumptions to reflect current real estate market conditions. Significant assumptions reviewed and updated include the capitalization rate, rental income and operating expenses. These adjusted assumptions are based upon recent appraisals received on similar properties as well as on actual experience related to real estate owned and currently under Company management.

The following tables present data on impaired loans at December 31, 2012 and 2011.

	As of or for the Year Ended December 31, 2012					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Int Paid YTD
Total Impaired with Reserve						
One- to four-family	$ 29,057	29,456	7,058	399	29,768	874
Over four-family	17,397	17,642	3,268	245	18,073	722
Home equity	1,544	1,544	1,033	-	1,615	74
Construction and land	2,316	2,316	377	-	2,316	78
Commercial real estate	813	1,179	341	366	1,748	50
Consumer	-	-	-	-	-	-
Commercial	1,352	1,352	331	-	1,352	42
	$ 52,479	53,489	12,408	1,010	54,872	1,840
Total Impaired with no Reserve						
One- to four-family	$ 28,410	31,315	-	2,905	31,358	1,175
Over four-family	10,884	11,179	-	295	11,649	549
Home equity	583	749	-	166	755	14
Construction and land	2,154	3,655	-	1,501	3,656	5
Commercial real estate	437	461	-	24	473	12
Consumer	24	24	-	-	24	1
Commercial	-	-	-	-	-	-
	$ 42,492	47,383	-	4,891	47,915	1,756
Total Impaired						
One- to four-family	$ 57,467	60,771	7,058	3,304	61,126	2,049
Over four-family	28,281	28,821	3,268	540	29,722	1,271
Home equity	2,127	2,293	1,033	166	2,370	88
Construction and land	4,470	5,971	377	1,501	5,972	83
Commercial real estate	1,250	1,640	341	390	2,221	62
Consumer	24	24	-	-	24	1
Commercial	1,352	1,352	331	-	1,352	42
	$ 94,971	100,872	12,408	5,901	102,787	3,596

The difference between a loan's recorded investment and the unpaid principal balance represents a partial charge-off resulting from a confirmed loss due to the value of the collateral securing the loan being below the loan balance and management's assessment that the full collection of the loan balance is not likely.

When a loan is considered impaired, interest payments received are treated as interest income on a cash basis as long as the remaining book value of the loan (i.e., after charge-off of all identified losses) is deemed to be fully collectible. If the remaining book value is not deemed to be fully collectible, all payments received are applied to unpaid principal. Determination as to the ultimate collectability of the remaining book value is supported by an updated credit department evaluation of the borrower's financial condition and prospects for repayment, including consideration of the borrower's sustained historical repayment performance and other relevant factors.

	As of or for the Year Ended December 31, 2011					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Int Paid YTD
Total Impaired with Reserve						
One- to four-family	$ 25,735	25,913	5,707	178	26,093	579
Over four-family	21,268	21,648	3,719	380	21,846	761
Home equity	1,428	1,428	803	-	1,448	2
Construction and land	6,543	6,543	2,077	-	6,543	113
Commercial real estate	-	-	-	-	-	-
Commercial	1,033	1,033	269	-	1,037	42
	$ 56,007	56,565	12,575	558	56,967	1,497
Total Impaired with no Reserve						
One- to four-family	$ 42,586	48,482	-	5,896	48,552	1,448
Over four-family	19,515	21,264	-	1,749	21,535	780
Home equity	799	799	-	-	833	3
Construction and land	1,893	3,413	-	1,520	3,413	60
Commercial real estate	515	539	-	24	538	17
Commercial	82	100	-	18	90	-
	$ 65,390	74,597	-	9,207	74,961	2,308
Total Impaired						
One- to four-family	$ 68,321	74,395	5,707	6,074	74,645	2,027
Over four-family	40,783	42,912	3,719	2,129	43,381	1,541
Home equity	2,227	2,227	803	-	2,281	5
Construction and land	8,436	9,956	2,077	1,520	9,956	173
Commercial real estate	515	539	-	24	538	17
Commercial	1,115	1,133	269	18	1,127	42
	$ 121,397	131,162	12,575	9,765	131,928	3,805

The determination as to whether an allowance is required with respect to impaired loans is based upon an analysis of the value of the underlying collateral and/or the borrower's intent and ability to make all principal and interest payments in accordance with contractual terms. The evaluation process is subject to the use of significant estimates and actual results could differ from estimates. This analysis is primarily based upon third party appraisals and/or a discounted cash flow analysis. In those cases in which no allowance has been provided for an impaired loan, the Company has determined that the estimated value of the underlying collateral exceeds the remaining outstanding balance of the loan. Of the total $42.5 million of impaired loans as of December 31, 2012 for which no allowance has been provided, $4.9 million in charge-offs have been recorded to reduce the unpaid principal balance to an amount that is commensurate with the loan's net realizable value, using the estimated fair value of the underlying collateral. To the extent that further deterioration in property values continues, the Company may have to reevaluate the sufficiency of the collateral servicing these impaired loans resulting in additional provisions to the allowance for loans losses or charge-offs.

The following presents data on troubled debt restructurings:

	As of December 31, 2012					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
			(dollars in thousands)			
One- to four-family	$ 9,921	17	$ 21,847	95	$ 31,768	112
Over four-family	3,917	4	20,030	13	23,947	17
Home equity	-	-	986	3	986	3
Construction and land	2,173	2	79	1	2,252	3
Commercial real estate	-	-	668	2	668	2
	$ 16,011	23	$ 43,610	114	$ 59,621	137

	As of December 31, 2011					
	Accruing		Non-accruing		Total	
	Amount	Number	Amount	Number	Amount	Number
			(dollars in thousands)			
One- to four-family	$ 8,293	26	$ 26,773	93	$ 35,066	119
Over four-family	14,845	13	2,453	8	17,298	21
Home equity	43	1	1,024	4	1,067	5
Construction and land	1,408	1	79	1	1,487	2
Commercial real estate	-	-	452	1	452	1
Commercial	-	-	42	2	42	2
	$ 24,589	41	$ 30,823	109	$ 55,412	150

Troubled debt restructurings involve granting concessions to a borrower experiencing financial difficulty by modifying the terms of the loan in an effort to avoid foreclosure. Typical restructured terms include six to twelve months of principal forbearance, a reduction in interest rate or both. In no instances have the restructured terms included a reduction of outstanding principal balance. At December 31, 2012, $59.6 million in loans had been modified in troubled debt restructurings and $43.6 million of these loans were included in the non-accrual loan total. The remaining $16.0 million, while meeting the internal requirements for modification in a troubled debt restructuring, were current with respect to payments under their original loan terms at the time of the restructuring and thus, continued to be included with accruing loans. Provided these loans perform in accordance with the modified terms, they will continue to be accounted for on an accrual basis.

All loans that have been modified in a troubled debt restructuring are considered to be impaired. As such, an analysis has been performed with respect to all of these loans to determine the need for a valuation reserve. When a loan is expected to perform in accordance with the restructured terms and ultimately return to and perform under contract terms, a valuation allowance is established for an amount equal to the excess of the present value of the expected future cash flows under the original contract terms as compared with the modified terms, including an estimated default rate. When there is doubt as to the borrower's ability to perform under the restructured terms or ultimately return to and perform under market terms, a valuation allowance is established equal to the impairment when the carrying amount exceeds fair value of the underlying collateral. As a result of the impairment analysis, a $6.4 million valuation allowance has been established as of December 31, 2012 with respect to the $59.6 million in troubled debt restructurings. As of December 31, 2011, $6.2 million in valuation allowance had been established with respect to the $55.4 million in troubled debt restructurings.

After a troubled debt restructuring reverts to market terms, a minimum of six consecutive contractual payments must be received prior to consideration for a return to accrual status. If an updated credit department review indicates no other evidence of elevated credit risk, the loan is returned to accrual status at that time.

The following presents troubled debt restructurings by concession type at December 31, 2012 and 2011:

	As of December 31, 2012						
	Performing in accordance with modified terms		In Default		Total		
	Amount		Number	Amount	Number	Amount	Number
	(dollars in thousands)						
Interest reduction and principal forebearance	$	26,051	77	2,770	11	28,821	88
Principal forebearance		17,574	11	348	1	17,922	12
Interest reduction		11,984	35	894	2	12,878	37
	$	55,609	123	4,012	14	59,621	137

	As of December 31, 2011						
	Performing in		In Default		Total		
	Amount		Number	Amount	Number	Amount	Number
	(dollars in thousands)						
Interest reduction and principal forebearance	$	22,752	61	6,564	22	29,316	83
Principal forebearance		3,894	29	1,771	9	5,665	38
Interest reduction		20,006	27	425	2	20,431	29
	$	46,652	117	8,760	33	55,412	150

The following presents data on troubled debt restructurings:

	For the Year Ended					
	December 31, 2012			December 31, 2011		
	Amount		Number	Amount		Number
	(dollars in thousands)			(dollars in thousands)		
Loans modified as a troubled debt restructure						
One- to four-family	$	14,821	27	$	23,049	86
Over four-family		18,520	8		10,340	12
Home equity		12	1		1,062	3
Land and construction		764	1		-	-
	$	34,117	37	$	34,451	101
Troubled debt restructuring modified within the past twelve months for which there was a default						
One- to four-family		-	-	$	702	6
	$	-	-	$	702	6

The following table presents data on non-accrual loans:

	As of December 31,	
	2012	**2011**
	(Dollars in Thousands)	
Residential		
One- to four-family	$ 46,467	$ 55,609
Over four-family	23,205	13,680
Home equity	1,578	1,334
Construction and land	2,215	6,946
Commercial real estate	668	514
Commercial	511	135
Consumer	24	-
Total non-accrual loans	$ 74,668	$ 78,218
Total non-accrual loans to total loans, net	6.59%	6.43%
Total non-accrual loans and performing troubled debt restructurings to total loans receivable	8.00%	8.45%
Total non-accrual loans to total assets	4.50%	4.57%

4) Office Properties and Equipment

Office properties and equipment are summarized as follows:

	December 31, 2012	December 31, 2011
	(In Thousands)	
Land	$ 6,836	6,959
Office buildings and improvements	29,652	29,583
Furniture and equipment	12,347	10,679
	48,835	47,221
Less accumulated depreciation	(21,900)	(19,865)
	$ 26,935	27,356

Depreciation of premises and equipment totaled $2.1 million, $1.8 million and $1.9 million for the years ended December 31, 2012, 2011 and 2010, respectively.

The Company and certain subsidiaries are obligated under non-cancelable operating leases for other facilities and equipment. Rent and equipment lease expense totaled $2.8 million, $2.6 million and $1.9 million for the years ended December 31, 2012, 2011 and 2010, respectively. The appropriate minimum annual commitments under all non-cancelable lease agreements as of December 31, 2012 are as follows:

	Operating leases (In Thousands)
Within one year	$ 1,664
One to two years	916
Two to three years	390
Three to four years	230
Four through five years	23
After five years	—
Total	$ 3,223

5) Real Estate Owned

Real estate owned is summarized as follows:

	December 31, 2012	December 31, 2011
	(In Thousands)	
One- to four-family	$ 17,353	27,449
Over four-family	9,890	16,231
Construction and land	7,029	8,796
Commercial real estate	1,702	4,194
	$ 35,974	56,670

The following table presents the activity in real estate owned:

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(In Thousands)	
Real estate owned at beginning of period	$ 56,670	57,752
Transferred in from loans receivable	22,282	28,259
Sales	(35,159)	(22,432)
Write downs	(7,562)	(6,825)
Other activity	(257)	(84)
Real estate owned at end of period	$ 35,974	56,670

6) Mortgage Servicing Rights

The following table presents the activity related to the Company's mortgage servicing rights:

	Year ended December 31, 2012	Year ended December 31, 2011
	(In Thousands)	
Mortgage servicing rights at beginning of the period	$ 198	$ 42
Additions	3,411	169
Amortization	(389)	(13)
Mortgage servicing rights at end of the period	3,220	198
Valuation allowance at end of period	-	-
Mortgage servicing rights at the end of the period, net	$ 3,220	$ 198

The following table shows the estimated future amortization expense for mortgage servicing rights at December 31, 2012 for the periods indicated:

		(In Thousands)
Estimate for the years ended December 31:	2013	890
	2014	747
	2015	603
	2016	459
	2017	316
	Thereafter	205
	Total	3,220

7) Deposits

At December 31, 2012 and 2011, time deposits with balances greater than $100,000 amounted to $193.6 million and $232.8 million, respectively.

A summary of interest expense on deposits is as follows:

	Years ended December 31,		
	2012	2011	2010
		(In Thousands)	
Interest-bearing demand deposits	$ 23	30	37
Money market and savings deposits	272	369	493
Time deposits	9,182	14,890	20,459
	$ 9,477	15,289	20,989

A summary of the contractual maturities of time deposits at December 31, 2012 is as follows:

	(In Thousands)
Within one year	$ 454,561
One to two years	236,816
Two to three years	15,006
Three to four years	6,269
Four through five years	24,248
After five years	20
	$ 736,920

8) Borrowings

Borrowings consist of the following:

	December 31, 2012		December 31, 2011	
	Balance	Weighted Average Rate	Balance	Weighted Average Rate
	(In Thousands)			
Short-term repurchase agreements	$ 45,888	3.09%	27,138	4.50%
Federal Home Loan Bank advances maturing:				
2016	220,000	4.34%	220,000	4.34%
2017	65,000	3.19%	65,000	3.19%
2018	65,000	2.97%	65,000	2.97%
Repurchase agreements maturing:				
2017	84,000	3.96%	84,000	3.96%
	$ 479,888	3.82%	461,138	3.93%

The short-term repurchase agreements represent the outstanding portion of a total $90.0 million commitment with two unrelated banks. The short-term repurchase agreements are utilized by Waterstone Mortgage Corporation to finance loans originated for sale. These agreements are secured by the underlying loans being financed. Related interest rates are based upon the note rate associated with the loans being financed. The first of short-term repurchase agreements has an outstanding balance of $38.1 million, a rate of 2.96% and a total commitment of $40.0 million at December 31, 2012. The second short-term repurchase agreement has an outstanding balance of $7.8 million, a rate of 3.75% and a total commitment of $50.0 million at December 31, 2012.

The $220.0 million in advances due in 2016 consist of eight advances with fixed rates ranging from 4.01% to 4.82% callable quarterly until maturity.

The $65.0 million in advances due in 2017 consist of three advances with fixed rates ranging from 3.09% to 3.46% callable quarterly until maturity.

The $65.0 million in advances due in 2018 consist of three advances with fixed rates ranging from 2.73% to 3.11% callable quarterly until maturity.

The $84.0 million in repurchase agreements have fixed rates ranging from 2.89% to 4.31% callable quarterly until their maturity in 2017. The repurchase agreements are collateralized by securities available for sale with an estimated fair value of $101.9 million at December 31, 2012.

The Company selects loans that meet underwriting criteria established by the Federal Home Loan Bank Chicago (FHLBC) as collateral for outstanding advances. The Company's borrowings at the FHLBC are limited to 75% of the carrying value of unencumbered one- to four-family mortgage loans, 40% of the carrying value of home equity loans and 60% of the carrying value of over four-family loans. In addition, these advances are collateralized by FHLBC stock of $20.2 million at December 31, 2012 and $21.7 million at December 31, 2011. In the event of prepayment, the Company is obligated to pay all remaining contractual interest on the advance.

9) Regulatory Capital

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements, or overall financial performance deemed by the regulators to be inadequate, can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2012, that the Bank meets all capital adequacy requirements to which it is subject.

On November 25, 2009, pursuant to a Stipulation and Consent to the Issuance of a Consent Order, WaterStone Bank agreed to the issuance of a Consent Order jointly issued by the Federal Deposit Insurance Corporation and the WDFI, WaterStone Bank's primary banking regulators. At the same time, pursuant to a Stipulation and Consent to Issuance of Order to Cease and Desist, Waterstone Financial, Inc. agreed to the issuance of an Order to Cease and Desist by the Office of Thrift Supervision, Waterstone Financial Inc.'s thrift holding company regulator at the time. The Order issued by the Office of Thrift Supervision requires, among other things, that WaterStone Bank maintain minimum Tier 1 capital of 8.5% of total average assets and minimum total risk-based capital of 12.0% of risk-weighted assets. Effective December 11, 2012, the WDFI and the Federal Deposit Insurance Corporation terminated the Order issued to WaterStone Bank. The terminated Order was replaced with a memorandum of understanding that requires, among other things, maintenance of a minimum Tier I capital of 8.0% and a minimum total risk based capital ratio of 12.0%, and also prohibits dividend payments without prior regulatory non-objection. Waterstone Financial, Inc. remains subject to its Order issued by the Office of Thrift Supervision, through enforcement by the Federal Reserve Board, as the successor holding company regulator to the Office of Thrift Supervision. At December 31, 2012, the Company is in compliance with all requirements of the memorandum of understanding and order to cease and desist.

As of December 31, 2012 the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as quantitatively "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios, as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

As a state-chartered savings bank, the Bank is required to meet minimum capital levels established by the state of Wisconsin in addition to federal requirements. For the state of Wisconsin, regulatory capital consists of retained income, paid-in-capital, capital stock equity and other forms of capital considered to be qualifying capital by the Federal Deposit Insurance Corporation.

The actual and required capital amounts and ratios for the Bank as of December 31, 2012 and 2011 are presented in the table below:

	December 31, 2012					
	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars In Thousands)					
WaterStone Bank						
Total capital (to risk-weighted assets)	$ 199,098	17.34%	91,844	8.00%	114,806	10.00%
Tier I capital (to risk-weighted assets)	184,542	16.07%	45,922	4.00%	68,883	6.00%
Tier I capital (to average assets)	184,542	11.13%	66,312	4.00%	82,890	5.00%
State of Wisconsin (to total assets)	184,542	11.15%	99,305	6.00%	N/A	N/A
	December 31, 2011					
WaterStone Bank						
Total capital (to risk-weighted assets)	$ 174,144	14.58%	95,579	8.00%	119,474	10.00%
Tier I capital (to risk-weighted assets)	158,994	13.31%	47,790	4.00%	71,684	6.00%
Tier I capital (to average assets)	158,994	9.16%	69,447	4.00%	86,808	5.00%
State of Wisconsin (to total assets)	158,994	9.31%	102,463	6.00%	N/A	N/A

10) Stock Based Compensation

Stock-Based Compensation Plan

In 2006, the Company's shareholders approved the 2006 Equity Incentive Plan. All stock awards granted under this plan vest over a period of five years and are required to be settled in shares of the Company's common stock. The exercise price for all stock options granted is equal to the quoted NASDAQ market close price on the date that the awards were granted and expire ten years after the grant date, if not exercised. All restricted stock grants are issued from previously unissued shares.

Accounting for Stock-Based Compensation Plan

The fair value of stock options granted is estimated on the grant date using a Black-Scholes pricing model. The fair value of restricted shares is equal to the quoted NASDAQ market close price on the date of grant. The fair value of stock grants is recognized as compensation expense on a straight-line basis over the vesting period of the grants. Compensation expense is included in compensation, payroll taxes and other employee benefits in the consolidated statements of income.

Assumptions are used in estimating the fair value of stock options granted. The weighted average expected life of the stock options represent the period of time that the options are expected to be outstanding and is based on the SEC simplified approach to calculating expected term. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected volatility is based on the actual volatility of Waterstone Financial, Inc. stock from the original date of issue, October 4, 2005. The following assumptions were used in estimating the fair value of options granted in the year ended December 31, 2012 and 2010. There were no options granted during the year ended December 31, 2011.

	2012	2010
Dividend Yield	0.00%	0.00%
Risk-free interest rate	0.25%	0.25%
Expected volatility	74.53%	75.67%
Weighted average expected life	6.5 years	6.5 years
Weighted average per share value of options	$ 1.25	$ 2.54

The Company estimates potential forfeitures of stock grants and adjusts compensation expense recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods.

A summary of the Company's stock option activity for the years ended December 31, 2012, 2011 and 2010 is presented below.

Stock Options	Shares	Weighted Average Exercise Price	Weighted Average Years Remaining in Contractual Term	Aggregate Instrinsic Value (000's)
Outstanding December 31, 2009	757,500	17.41	7.07	-
Options exercisable at December 31, 2009	298,000	17.60	7.03	-
Granted	50,000	$ 3.80		-
Exercised	-			-
Forfeited	(5,000)	17.67		-
Outstanding December 31, 2010	802,500	16.44	6.34	-
Options exercisable at December 31, 2010	446,500	17.54	6.04	-
Granted	-			-
Exercised	-			-
Forfeited	(10,000)	17.16		-
Outstanding December 31, 2011	792,500	16.32	5.37	-
Options exercisable at December 31, 2011	599,000	17.28	5.12	-
Granted	255,000	$ 2.03		-
Exercised	(3,000)	4.65		9
Forfeited	(24,000)	8.93		(72)
Outstanding December 31, 2012	1,020,500	13.11	5.69	1,622
Options exercisable at December 31, 2012	744,500	16.59	4.31	80

The following table summarizes information about the Company's nonvested stock option activity for the years ended December 31, 2012 and 2011:

Stock Options	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2010	356,000	$ 5.60
Granted	-	
Vested	(160,500)	5.79
Forfeited	(2,000)	6.04
Nonvested at December 31, 2011	193,500	5.31
Nonvested at December 31, 2011	193,500	$ 5.31
Granted	255,000	1.33
Vested	(158,500)	5.78
Forfeited	(14,000)	1.32
Nonvested at December 31, 2012	276,000	1.48

The Company amortizes the expense related to stock options as compensation expense over the vesting period. During the year ended December 31, 2012, 255,000 options were granted, 24,000 were forfeited, of which 10,000 were vested and 3,000 shares were exercised. During the year ended December 31, 2011, 10,000 were forfeited, of which 8,000 were vested. During the year ended December 31, 2010, 50,000 options were granted and 5,000 were forfeited, of which 2,000 were vested.

Expense for the stock options granted of $94,000, $745,000 and $810,000 was recognized during the years ended December 31, 2012, 2011 and 2010, respectively. At December 31, 2012, the Company had $305,000 in estimated unrecognized compensation costs related to outstanding stock options that is expected to be recognized over a weighted average period of 40 months.

The following table summarizes information about the Company's restricted stock shares activity for the years ended December 31, 2012 and 2011:

Restricted Stock	**Shares**	**Weighted Average Grant Date Fair Value**
Nonvested at December 31, 2010	101,400	$ 16.91
Granted	-	-
Vested	(49,200)	17.24
Forfeited	-	-
Nonvested at December 31, 2011	52,200	16.61
Nonvested at December 31, 2011	52,200	16.61
Granted	100,000	1.89
Vested	(49,200)	17.24
Forfeited	(2,000)	4.65
Nonvested at December 31, 2012	101,000	1.96

The Company amortizes the expense related to restricted stock awards as compensation expense over the vesting period. During the year ended December 31, 2012, 100,000 shares of restricted stock were granted and 2,000 were forfeited. During the years ended December 31, 2011 and 2010, no shares of restricted stock were awarded and no shares were forfeited. Expense for the restricted stock awards of $51,000, $848,000 and $848,000 was recorded for the years ended December 31, 2012, 2011 and 2010, respectively. At December 31, 2012, the Company had $158,000 of unrecognized compensation expense related to restricted stock shares that is expected to be recognized over a weighted average period 40 months.

11) Employee Benefit Plans

The Company has two 401(k) profit sharing plans and trusts covering substantially all employees. WaterStone Bank employees over 18 years of age are immediately eligible to participate in the Bank's Plan. Waterstone Mortgage employees over 21 years of age are eligible to participate in its Plan as of the first of the month following their date of employment. Participating employees may annually contribute pretax compensation in accordance with IRS limits. The Company made a contribution of $70,000 to one of the Plans during the year ended December 31, 2012. The Company made no contributions to the Plans during the years ended December 31, 2011 and 2010.

The Company has a nonqualified salary continuation plan for one former employee. This agreement provides for payments of specific amounts over a 10-year period subsequent to the employee's retirement. The deferred compensation liability was accrued ratably to the employee's respective normal retirement date. Payments made to the retired employee reduce the liability. As of December 31, 2012 and 2011, approximately $687,000 and $826,000 was accrued related to this plan. This agreement is funded by a life insurance policy with a death benefit of $6.4 million and a cash surrender value of $3.3 million and $2.9 million at December 31, 2012 and 2011, respectively. The former employee has no interest in this policy. There was no expense for compensation under this agreement during the years ended December 31, 2012, 2011 and 2010.

12) Employee Stock Ownership Plan

All employees are eligible to participate in the WaterStone Bank Employee Stock Ownership Plan (the "Plan") after they attain twenty-one years of age and complete twelve consecutive months of service in which they work at least 1,000 hours of service. During the year ended December 31, 2005, the Plan borrowed $8.5 million from the Company and purchased 761,515 shares of common stock of the Company in the open market. The Plan debt is secured by shares of the Company. The Company has committed to make annual contributions to the Plan necessary to repay the loan, including interest. The loan is scheduled to be repaid in ten annual installments through the year ended December 31, 2015. While the shares are not released and allocated to Plan participants until the loan payment is made, the shares are deemed to be earned and are therefore, committed to be released throughout the service period. As such, one-tenth of the shares are scheduled to be released annually as shares are earned over a period of ten years, beginning with the period ended December 31, 2005. As the debt is repaid, shares are released from collateral and allocated to active participant accounts. The shares pledged as collateral are reported as "Unearned ESOP shares" in the consolidated statement of financial condition. As shares are committed to be released from collateral, the Company reports compensation expense equal to the average fair market price of the shares, and the shares become outstanding for earnings per share computations. Compensation expense attributed to the ESOP was $306,000, $202,000 and $264,000, respectively for the years ended December 31, 2012, 2011 and 2010.

The aggregate activity in the number of unearned ESOP shares, considering the allocation of those shares committed to be released as of December 31, is as follows:

	2012	2011
Beginning ESOP shares	228,453	304,605
Shares committed to be released	(76,151)	(76,152)
Unreleased shares	152,302	228,453
Fair value of unreleased shares (in thousands)	$ 1,188	432

13) Income Taxes

The provision (benefit) for income taxes for the year ended December 31, 2012, 2011 and 2010 consists of the following:

	Years ended December 31,		
	2012	**2011**	**2010**
		(In Thousands)	
Current:			
Federal	$ 4,256	1,216	30
State	435	81	22
	4,691	1,297	52
Deferred:			
Federal	(12,664)	(590)	—
State	(4,231)	(145)	—
	(16,895)	(735)	—
Total	$ (12,204)	562	52

The income tax provisions differ from that computed at the Federal statutory corporate tax rate for the years ended December 31, 2012, 2011 and 2010 as follows:

	Years ended December 31,		
	2012	**2011**	**2010**
		(Dollars In Thousands)	
Income (loss) before income taxes	$ 22,710	(6,911)	(1,802)
Tax at Federal statutory rate (35%)	7,949	(2,419)	(631)
Add (deduct) effect of:			
State income taxes net of Federal income tax benefit (expense)	(2,467)	(41)	14
Cash surrender value of life insurance	(375)	(393)	(398)
Non-deductible ESOP and stock option expense	103	119	168
Tax-exempt interest income	(185)	(254)	(294)
Reversal of federal valuation allowance on deferred taxes	(17,008)	2,921	1,281
Intra-period tax allocation between other comprehensive income and loss from operations	-	(591)	-
Increase in tax exposure reserve	(184)	1,216	-
Other	(37)	4	(88)
Income tax provision (benefit)	(12,204)	562	52
Effective tax rate	(53.7%)	(8.1%)	(2.9%)

Deferred tax asset valuation allowances originally established in 2008 were fully reversed at December 31, 2012. Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is “more likely than not” that a deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, the forecasts of future income, applicable tax planning strategies, and assessments of current and future economic and business conditions. Examples of positive evidence may include the existence of taxes paid in available carry back years as well as the probability that taxable income will be generated in future periods, while examples of negative evidence may include the cumulative losses in the current year and prior two years and general business and economic trends. In addition, general uncertainty surrounding future economic and business conditions increased the potential volatility and uncertainty of projected earnings. At both December 31, 2011 and 2010, the Company determined a valuation allowance was necessary, largely based on the negative evidence represented by a cumulative loss in the most recent three-year period caused by the significant loan loss provisions recorded during the period. At December 31, 2012, pretax income in each of the four quarters in 2012 and for the year, the existence of taxes paid in 2012 and available for carry back in future years, applicable tax planning strategies and general economic conditions resulted in the conclusion that as of December 31, 2012, it is more likely than not that net deferred tax assets will be realized in future periods.

The income tax provision for 2011 includes a federal and state tax benefit of $736,000 due to an intra-period tax allocation between other comprehensive income and loss from continuing operations representing an out-of-period adjustment for an error that originated beginning in 2008 that was corrected during the quarter ended June 30, 2011. The correction of the error was not material to the year ended December 31, 2011. The impact of this error to all prior periods was not deemed to be material.

The significant components of the Company's net deferred tax assets (liabilities) included in prepaid expenses and other assets are as follows at December 31, 2012 and 2011:

	December 31, 2012	December 31, 2011
	(In Thousands)	
Gross deferred tax assets:		
Excess book depreciation	$ 653	617
Compensation agreements	277	335
Restricted stock and stock options	935	1,252
Allowance for loan losses	12,316	13,113
Repurchase reserve for loans sold	357	—
Real estate owned write-downs	4,005	4,826
Interest recognized for tax but not books	1,609	1,169
Federal NOL carryforward	—	915
State NOL carryforward	817	1,563
Unrealized loss on impaired securities	—	841
Other	426	213
Total gross deferred tax assets	21,395	24,844
Valuation allowance	—	(21,270)
Deferred tax assets	21,395	3,574
Gross deferred tax liabilities:		
Unrealized gain on securities available for sale, net	(1,834)	(1,228)
Mortgage servicing rights	(1,278)	—
FHLB stock dividends	(858)	(931)
Deferred loan fees	(639)	(859)
Deferred liabilities	(4,609)	(3,018)
Net deferred tax assets	$ 16,786	556

The Company had a Federal NOL carry forward of $3.0 million at December 31, 2011 which was fully utilized in 2012. The Company has a non-sharable Wisconsin NOL carry forward of $17.5 million at December 31, 2012 generated by the community banking segment which will begin to expire in 2028.

Under the Internal Revenue Code and Wisconsin Statutes, the Company was permitted to deduct, for tax years beginning before 1988, an annual addition to a reserve for bad debts. This amount differs from the provision for loan losses recorded for financial accounting purposes. Under prior law, bad debt deductions for income tax purposes were included in taxable income of later years only if the bad debt reserves were used for purposes other than to absorb bad debt losses. Because the Company did not intend to use the reserve for purposes other than to absorb losses, no deferred income taxes were provided. Retained earnings at December 31, 2012 include approximately $16.7 million for which no deferred Federal or state income taxes were provided. Deferred income taxes have been provided on certain additions to the tax reserve for bad debts.

The Company and its subsidiaries file consolidated federal and state tax returns. One subsidiary also files separate state income tax returns in certain states. The Company is no longer subject to federal income tax examinations by tax authorities for years before 2010 and state income taxes for years before 2005.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2012	2011
	(In Thousands)	
Balance at January 1	$ 2,004	-
Increases related to prior year tax positions	13	1,526
Increases related to current year tax positions	2	478
Decreases related to prior year tax positions	(1,948)	-
Balance at December 31	$ 71	2,004

The Internal Revenue Service (IRS) commenced an examination of the Company's income tax returns for 2005 through 2009 in the first quarter of 2010. In the fourth quarter of 2011, the IRS proposed significant adjustments related to the Company's deduction of expenses related to real estate owned and acquired through foreclosure, loan loss charge-offs and state tax deductions. All of these significant proposed adjustments are timing differences which resulted in current tax expense offset by deferred tax benefit to be realized in future periods. In the second quarter of 2012, a payment of $982,000 was made towards the proposed IRS adjustment. Final settlement of interest due is still pending.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. During the year ended December 31, 2011, the Company recognized $241,000 in interest which was accrued for as of December 31, 2011. The Company recognized no interest or penalties during the years ended December 31, 2012 and 2010. The Company had an accrual for the payment of interest and penalties of $53,000 at December 31, 2012, $241,000 at December 31, 2011 and zero at December 31, 2010.

14) Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

	December 31,	
	2012	2011
	(In Thousands)	
Financial instruments whose contract amounts represent potential credit risk:		
Commitments to extend credit under first mortgage loans	$ 20,836	14,259
Commitments to extend credit under home equity lines of credit	17,628	21,403
Unused portion of construction loans	5,502	5,684
Unused portion of business lines of credit	10,967	10,347
Standby letters of credit	736	970

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds mortgages on the underlying real estate as collateral supporting those commitments for which collateral is deemed necessary.

The Company has determined that there are no probable losses related to commitments to extend credit or the standby letters of credit as of December 31, 2012 and 2011.

15) Derivative Financial Instruments

In connection with its mortgage banking activities, the Company enters into derivative financial instruments as part of its strategy to manage its exposure to changes in interest rates. Mortgage banking derivatives include interest rate lock commitments provided to customers to fund mortgage loans to be sold in the secondary market and forward commitments for the future delivery of such loans. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of future changes in interest rates on its commitments to fund the loans as well as on its portfolio of mortgage loans held-for-sale. The Company's mortgage banking derivatives have not been designated as being in hedge relationships. These instruments are used to manage the Company's exposure to interest rate movements and other identified risks but do not meet the strict hedge accounting requirements of ASC 815. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in earnings. The Company does not use derivatives for speculative purposes.

Forward commitments to sell mortgage loans represent commitments obtained by the Company from a secondary market agency to purchase mortgages from the Company at specified interest rates and within specified periods of time. Commitments to sell loans are made to mitigate interest rate risk on interest rate lock commitments to originate loans and loans held for sale. At December 31, 2012, the Company had forward commitments to sell mortgage loans with an aggregate notional amount of $138.1 million and interest rate lock commitments with an aggregate notional amount of $147.9 million. The fair value of the mortgage derivatives at December 31, 2012 included a gain of $1.7 million on mortgage banking derivative assets and a $249,000 net loss on mortgage banking liabilities that are reported as a component of other asset and other liabilities, respectively on the Company's consolidated statements of financial condition.

In determining the fair value of its derivative loan commitments, the Company considers the value that would be generated when the loan arising from exercise of the loan commitment is sold in the secondary mortgage market. That value includes the price that the loan is expected to be sold for in the secondary mortgage market. The fair value of these commitments is recorded on the consolidated statements of financial condition with the changes in fair value recorded as a component of mortgage banking income.

16) Fair Values Measurements

ASC Topic 820, "Fair Value Measurements and Disclosures" defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This accounting standard applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements. The standard also emphasizes that fair value (i.e., the price that would be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date), among other things, is based on exit price versus entry price, should include assumptions about risk such as nonperformance risk in liability fair values, and is a market-based measurement, not an entity-specific measurement. When considering the assumptions that market participants would use in pricing the asset or liability, this accounting standard establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

The fair value hierarchy prioritizes inputs used to measure fair value into three broad levels.

Level 1 inputs - In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that we have the ability to access.

Level 2 inputs - Fair values determined by Level 2 inputs use inputs other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets where there are few transactions and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Level 3 inputs are unobservable inputs for the asset or liability and include situations where there is little, if any, market activity for the asset or liability.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The following table presents information about our assets recorded in our consolidated statement of financial position at their fair value on a recurring basis as of December 31, 2012 and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

	December 31, 2012	Fair Value Measurements Using Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$ 119,056	-	119,056	-
Collateralized mortgage obligations				
Government sponsored enterprise issued	29,579	-	29,579	-
Government sponsored enterprise bonds	8,017	-	8,017	-
Municipal securities	37,371	-	37,371	-
Other debt securities	5,070	5,070	-	-
Certificates of deposit	5,924	-	5,924	-
Loans held for sale	133,613	-	133,613	-
Mortgage banking derivative assets	1,668	-	-	1,668
Mortgage banking derivative liabilities	249	-	-	249

	December 31, 2011	Fair Value Measurements Using Level 1	Level 2	Level 3
	(In Thousands)			
Available for sale securities				
Mortgage-backed securities	$ 35,417	-	35,417	-
Collateralized mortgage obligations				
Government sponsored enterprise issued	33,196	-	33,196	-
Private-label issued	18,451	-	-	18,451
Government sponsored enterprise bonds	71,349	-	71,349	-
Municipal securities	39,068	-	39,068	-
Other debt securities	5,118	5,118	-	-
Certificates of deposit	3,920	-	3,920	-
Loans held for sale	88,283	-	88,283	-
Mortgage banking derivative assets	924	-	-	924
Mortgage banking derivative liabilities	397	-	-	397

The following summarizes the valuation techniques for assets recorded in our consolidated statements of financial condition at their fair value on a recurring basis:

Available for sale securities – The Company's investment securities classified as available for sale include: mortgage-backed securities, collateralized mortgage obligations, government sponsored enterprise bonds, municipal securities and other debt securities. The fair value of mortgage-backed securities, collateralized mortgage obligations and government sponsored enterprise bonds are determined by a third party valuation source using observable market data utilizing a matrix or multi-dimensional relational pricing model. Standard inputs to these models include observable market data such as benchmark yields, reported trades, broker quotes, issuer spreads, benchmark securities, prepayment models and bid/offer market data. For securities with an early redemption feature, an option adjusted spread model is utilized to adjust the issuer spread. These model and matrix measurements are classified as Level 2 and Level 3 in the fair value hierarchy. The fair value of municipal securities is determined by a third party valuation source using observable market data utilizing a multi-dimensional relational pricing model. Standard inputs to this model include observable market data such as benchmark yields, reported trades, broker quotes, rating updates and issuer spreads. These model measurements are classified as Level 2 in the fair value hierarchy. The fair value of other debt securities, which includes a trust preferred security issued by a financial institution, is determined through quoted prices in active markets and is classified as Level 1 in the fair value hierarchy.

Loans held for sale – The Company carries loans held for sale at fair value under the fair value option model. Fair value is generally determined by estimating a gross premium or discount, which is derived from pricing currently observable in the secondary market, principally from observable prices for forward sale commitments. Loans held-for-sale are considered to be Level 2 in the fair value hierarchy of valuation techniques.

Mortgage banking derivatives - Mortgage banking derivatives include interest rate lock commitments to originate residential loans held for sale to individual customers and forward commitments to sell residential mortgage loans to various investors. The Company utilizes a valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale, which includes applying a pull through rate based upon historical experience and the current interest rate environment and then multiplying by quoted investor prices. The Company also utilizes a valuation model to estimate the fair value of its forward commitments to sell residential loans, which includes matching specific terms and maturities of the forward commitments against applicable investor pricing available. While there are Level 2 and 3 inputs used in the valuation models, the Company has determined that one or more of the inputs significant in the valuation of both of the mortgage banking derivatives fall within Level 3 of the fair value hierarchy.

The table below presents reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2012 and 2011.

	Available for sale securities	Mortgage banking derivatives, net
	(In Thousands)	
Balance at December 31, 2010	$ 20,301	407
Transfer into level 3	-	-
Unrealized holding losses arising during the period:		
Included in other comprehensive income	(142)	-
Other than temporary impairment included in net loss	(456)	-
Principal repayments	(1,252)	-
Net accretion of discount/amortization of premium	-	-
Mortgage derivative gain, net	-	120
Balance at December 31, 2011	18,451	527
Transfer into level 3	-	-
Unrealized holding losses arising during the period:		
Included in other comprehensive income	1,023	-
Other than temporary impairment included in net loss	(113)	-
Principal repayments	(1,352)	-
Net accretion of discount/amortization of premium	-	-
Sales of available for sale securities	(18,009)	
Mortgage derivative gain, net	-	892
Balance at December 31, 2012	$ -	1,419

Prior to December 31, 2012, level 3 available-for-sale securities included two corporate collateralized mortgage obligations. The market for these securities was not active as of December 31, 2011. As such, the Company valued these securities based on the present value of estimated future cash flows.

Assets Recorded at Fair Value on a Non-recurring Basis

The following table presents information about our assets recorded in our consolidated statement of financial position at their fair value on a non-recurring basis as of December 31, 2012 and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

		Fair Value Measurements Using		
	December 31, 2012	**Level 1**	**Level 2**	**Level 3**
	(In Thousands)			
Impaired loans, net (1)	$ 40,071	-	-	40,071
Real estate owned	35,974	-	-	35,974

		Fair Value Measurements Using		
	December 31, 2011	**Level 1**	**Level 2**	**Level 3**
	(In Thousands)			
Impaired loans, net (1)	$ 43,432	-	-	43,432
Real estate owned	56,670	-	-	56,670

(1) Represents collateral-dependent impaired loans, net, which are included in loans.

Loans – We do not record loans at fair value on a recurring basis. On a non-recurring basis, loans determined to be impaired are analyzed to determine whether a collateral shortfall exists, and if such a shortfall exists, are recorded on our consolidated statements of financial condition at net realizable value of the underlying collateral. Fair value is determined based on third party appraisals. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of impaired loans, loans that have been deemed to be impaired are considered to be Level 3 in the fair value hierarchy of valuation techniques. At December 31, 2012, loans determined to be impaired with an outstanding balance of $52.5 million were carried net of specific reserves of $12.4 million for a fair value of $40.1 million. At December 31, 2011, loans determined to be impaired with an outstanding balance of $56.0 million were carried net of specific reserves of $12.6 million for a fair value of $43.4 million. Impaired loans collateralized by assets which are valued in excess of the net investment in the loan do not require any specific reserves.

Real estate owned – On a non-recurring basis, real estate owned, is recorded in our consolidated statements of financial condition at the lower of cost or fair value. Fair value is determined based on third party appraisals and, if less than the carrying value of the foreclosed loan, the carrying value of the real estate owned is adjusted to the fair value. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. Given the significance of the adjustments made to appraised values necessary to estimate the fair value of the properties, real estate owned is considered to be Level 3 in the fair value hierarchy of valuation techniques. Changes in the fair value of real estate owned totaled $7.6 million and $6.8 million during the year ended December 31, 2012 and 2011, respectively and are recorded in real estate owned expense. At December 31, 2012 and December 31, 2011, real estate owned totaled $36.0 million and $56.7 million, respectively.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2012, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value at December 31, 2012	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value	
				Minimum Value	Maximum Value
Mortgage banking derivatives	1,419	Pricing models	Pull through rate	68.9%	100.0%
Impaired loans	40,071	Market approach	Disount rates applied to appraisals	15.0%	30.0%
Real estate owned	35,974	Market approach	Disount rates applied to appraisals	5.0%	76.5%

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The significant unobservable input used in the fair value measurement of the Company's mortgage banking derivatives, including interest rate lock commitments, is the loan pull through rate. This represents the percentage of loans currently in a lock position which the Company estimates will ultimately close. Generally, the fair value of an interest rate lock commitment will be positively (negatively) impacted when the prevailing interest rate is lower (higher) than the interest rate lock commitment. Generally, an increase in the pull through rate will result in the fair value of the interest rate lock increasing when in a gain position, or decreasing when in a loss position. The pull through rate is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. The pull through rate is computed using historical data and the ratio is periodically reviewed by the Company.

The significant unobservable inputs used in the fair value measurement of collateral for collateral-dependent impaired loans and real estate owned included in the above table primarily relate to discounting criteria applied to independent appraisals received with respect to the collateral. Discounts applied to the appraisals are dependent on the vintage of the appraisal as well as the marketability of the property. The discount factor is computed using actual realization rates on properties that have been foreclosed upon and liquidated in the open market.

Fair value information about financial instruments follows, whether or not recognized in the consolidated statements of financial condition, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The carrying amounts and fair values of the Company's financial instruments consist of the following at December 31, 2012 and December 31, 2011:

	December 31, 2012					December 31, 2011	
	Carrying amount	Fair Value				Carrying amount	Fair value
		Total	Level 1	Level 2	Level 3		
	(In Thousands)						
Financial Assets							
Cash and cash equivalents	$ 71,649	71,469	71,469	-	-	80,380	80,380
Securities available-for-sale	205,017	205,017	5,070	199,947	-	206,519	206,519
Securities held-to-maturity	-	-	-	-	-	2,648	2,542
Loans held for sale	133,613	133,613	-	133,613	-	88,283	88,283
Loans receivable	1,133,672	1,148,107	-	-	1,148,107	1,216,664	1,225,141
FHLB stock	20,193	20,193	-	20,193	-	21,653	21,653
Cash surrender value of life insurance	38,061	38,061	38,061	-	-	36,749	36,749
Real estate owned	35,974	35,974	-	-	35,974	56,670	56,670
Accrued interest receivable	3,452	3,452	3,452	-	-	4,064	4,064
Mortgage banking derivative assets	1,668	1,668	-	-	1,668	924	924
Financial Liabilities							
Deposits	939,513	942,118	202,593	739,525	-	1,051,292	1,052,663
Advance payments by borrowers for taxes	1,672	1,672	1,672	-	-	942	942
Borrowings	479,888	537,299	-	537,299	-	461,138	517,624
Accrued interest payable	1,715	1,715	1,715	-	-	2,087	2,087
Mortgage banking derivative liabilities	249	249	-	-	249	397	397
Other Financial Instruments							
Stand-by letters of credit	5	5	-	-	5	6	6

The following methods and assumptions were used by the Company in determining its fair value disclosures for financial instruments.

Cash and Cash Equivalents

The carrying amount reported in the consolidated statements of financial condition for cash and cash equivalents is a reasonable estimate of fair value for these short-term instruments.

Securities

The fair value of securities is determined by a third party valuation source using observable market data utilizing a matrix or multi-dimensional relational pricing model. Standard inputs to these models include observable market data such as benchmark yields, reported trades, broker quotes, issuer spreads, benchmark securities and bid/offer market data. For securities with an early redemption feature, an option adjusted spread model is utilized to adjust the issuer spread. Prepayment models are used for mortgage related securities with prepayment features.

Loans Held for Sale

Fair value is estimated using the prices of the Company's existing commitments to sell such loans and/or the quoted market price for commitments to sell similar loans.

Loans Receivable

Loans determined to be impaired are analyzed to determine whether a collateral shortfall exists, and if such a shortfall exists, are recorded on our consolidated statements of financial condition at fair value. Fair value is determined based on third party appraisals. Appraised values are adjusted to consider disposition costs and also to take into consideration the age of the most recent appraisal. With respect to loans that are not considered to be impaired, fair value is estimated by discounting the future contractual cash flows using discount rates that that reflect a current rate offered to borrowers of similar credit standing for the remaining term to maturity. This method of estimating fair value does not incorporate the exit-price concept of fair value prescribed by ASC 820-10 and generally produces a higher fair value.

FHLB Stock

For FHLB stock, the carrying amount is the amount at which shares can be redeemed with the FHLB and is a reasonable estimate of fair value.

Cash Surrender Value of Life Insurance

The carrying amounts reported in the consolidated statements of financial condition for the cash surrender value of life insurance approximate those assets' fair values.

Deposits and Advance Payments by Borrowers for Taxes

The fair values for interest-bearing and noninterest-bearing negotiable order of withdrawal accounts, savings accounts, and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates of similar remaining maturities to a schedule of aggregated expected monthly maturities of the outstanding certificates of deposit. The advance payments by borrowers for taxes are equal to their carrying amounts at the reporting date.

Borrowings

Fair values for borrowings are estimated using a discounted cash flow calculation that applies current interest rates to estimated future cash flows of the borrowings.

Accrued Interest Payable and Accrued Interest Receivable

For accrued interest payable and accrued interest receivable, the carrying amount is a reasonable estimate of fair value.

Commitments to Extend Credit and Standby Letters of Credit

Commitments to extend credit and standby letters of credit are generally not marketable. Furthermore, interest rates on any amounts drawn under such commitments would be generally established at market rates at the time of the draw. Fair values for the Company's commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the counterparty's credit standing, and discounted cash flow analyses. The fair value of the Company's commitments to extend credit is not material at December 31, 2012 and 2011.

Mortgage Banking Derivative Assets and Liabilities

Mortgage banking derivatives include interest rate lock commitments to originate residential loans held for sale to individual customers and forward commitments to sell residential mortgage loans to various investors. The Company utilizes a valuation model to estimate the fair value of its interest rate lock commitments to originate residential mortgage loans held for sale, which includes applying a pull through rate based upon historical experience and the current interest rate environment, and then multiplying by quoted investor prices. The Company also utilizes a valuation model to estimate the fair value of its forward commitments to sell residential loans, which includes matching specific terms and maturities of the forward commitments against applicable investor pricing available. On the Company's Consolidated Statements of Condition, instruments that have a positive fair value are included in prepaid expenses and other assets, and those instruments that have a negative fair value are included in other liabilities.

17) Earnings (loss) per share

Earnings per share are computed using the two-class method. Basic earnings (loss) per share is computed by dividing net income (loss) allocated to common shares by the weighted average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include unvested restricted shares. Unvested restricted shares are considered participating securities because holders of these securities have the right to receive dividends at the same rate as holders of the Company's common stock. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding adjusted for the dilutive effect of all potential common shares. Unvested restricted stock and stock options are considered outstanding for diluted earnings per share only. Unvested restricted stock and stock options totaling 101,000 and 276,000 shares for the year ended December 31, 2012 and 52,200 and 193,500 shares for the year ended December 31, 2011 and 101,400 and 356,000 shares for the year ended December 31, 2010 are antidilutive and are excluded from the loss per share calculation. Presented below are the calculations for basic and diluted earnings loss per share.

Waterstone Financial, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
Years Ended December 31, 2012, 2011 and 2010

	For the year ended December 31,		
	2012	**2011**	**2010**
	(In Thousands, except per share amounts)		
Net income (loss)	34,914	(7,473)	(1,854)
Net income available to unvested restricted stockholders	113	-	-
Net income (loss) available to common stockholders	$ 34,801	(7,473)	(1,854)
Weighted average shares outstanding	31,055	30,929	30,804
Effect of dilutive potential common shares	107	-	-
Diluted weighted average shares outstanding	31,162	30,929	30,804
Basic income (loss) per share	$ 1.12	(0.24)	(0.06)
Diluted income (loss) per share	$ 1.12	(0.24)	(0.06)

18) Condensed Parent Company Only Statements

Statements of Financial Condition

	December 31, 2012	December 31, 2011
	(In Thousands)	
Assets		
Cash and cash equivalents	$ 337	521
Securities available for sale (at fair value)	5,070	5,118
Investment in subsidiaries	195,451	160,933
Other assets	1,926	21
Total Assets	$ 202,784	166,593
Liabilities and shareholders' equity		
Liabilities:		
Other liabilities	150	221
Shareholders' equity		
Preferred Stock (par value $.01 per share)		
Authorized - 20,000,000 shares, no shares issued	-	-
Common stock (par value $.01 per share)		
Authorized - 200,000,000 shares in 2012 and 2011		
Issued - 34,072,909 in 2012 and 33,974,450 in 2011		
Outstanding - 31,348,556 in 2012 and 31,250,097 in 2011	341	340
Additional paid-in-capital	110,490	110,894
Retained earnings	136,487	101,573
Unearned ESOP shares	(1,708)	(2,562)
Treasury stock (2,724,353 shares), at cost	(45,261)	(45,261)
Accumulated other comprehensive income (net of taxes)	2,285	1,388
Total shareholders' equity	202,634	166,372
Total liabilities and shareholders' equity	$ 202,784	166,593

Statements of Operations

	For the year ended December 31,		
	2012	2011	2010
		(In Thousands)	
Interest income	$ 644	669	715
Equity in income (loss) of subsidiaries	33,448	(8,250)	(2,790)
Total income (loss)	34,092	(7,581)	(2,075)
Compensation	(523)	(605)	(541)
Professional fees	3	57	40
Other expense	279	440	280
Total expense	(241)	(108)	(221)
Income (loss) before income tax expense	34,333	(7,473)	(1,854)
Income tax benefit	(581)	-	-
Net income (loss)	$ 34,914	(7,473)	(1,854)

Statements of Cash Flows

	For the year ended December 31,		
	2012	2011	2010
		(In Thousands)	
Cash flows from operating activities			
Net income (loss)	$ 34,914	(7,473)	(1,854)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:			
Amortization of unearned ESOP	306	202	264
Stock based compensation	145	1,593	1,659
Deferred income taxes	(954)	(71)	319
Equity in (earnings) loss of subsidiaries	(33,448)	8,250	2,790
Change in other assets and liabilities	(1,147)	(1,537)	(2,067)
Net cash (used in) provided by operating actitivies	(184)	964	1,111
Cash flows used in investing activities:			
Capital contributions to subsidiary	-	(1,000)	(1,000)
Net cash used in investing activities	-	(1,000)	(1,000)
Net cash provided by (used in) financing activities	-	-	-
Net increase (decrease) in cash	(184)	(36)	111
Cash and cash equivalents at beginning of year	521	557	446
Cash and cash equivalents at end of year	$ 337	521	557

19) Segments and Related Information

During the year ended December 31, 2011, the Company determined that it has two reportable segments: community banking and mortgage banking. During this period, the Company realigned its operations to allow for all mortgage banking activities to be managed exclusively within its mortgage banking subsidiary. Based upon this realignment, the Company determined that the mortgage banking subsidiary represents a segment that is distinct from the operations of the core community banking function. Prior to the year ended December 31, 2011, the Company's operations were aligned such that it had one reportable segment. All segment data related to the year ended December 31, 2010 reflects the Company's operations in the same manner as they were aligned during the years ended December 31, 2012 and 2011. The Company's operating segments are presented based on its management structure and management accounting practices. The structure and practices are specific to the Company and therefore, the financial results of the Company's business segments are not necessarily comparable with similar information for other financial institutions.

Community Banking

The Community Banking segment provides consumer and business banking products and services to customers primarily within Southeastern Wisconsin. Consumer products include loan and deposit products: mortgage, home equity loans and lines, personal term loans, demand deposit accounts, interest bearing transaction accounts and time deposits. Business banking products include secured and unsecured lines and term loans for working capital, inventory and general corporate use, commercial real estate construction loans, demand deposit accounts, interest bearing transaction accounts and time deposits.

Mortgage Banking

The Mortgage Banking segment provides residential mortgage loans for the purpose of sale on the secondary market. Mortgage banking products and services are provided by offices in: Wisconsin, Arizona, Florida, Idaho, Indiana, Illinois, Iowa, Maryland, Minnesota, Ohio and Pennsylvania.

	As of or for the Year ended December 31, 2012			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(in thousands)			
Net interest income	$ 40,973	470	502	41,945
Provision for loan losses	8,250	50	-	8,300
Net interest income after provision for loan losses	32,723	420	502	33,645
Noninterest income	3,259	87,944	-	91,203
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	13,424	50,748	(665)	63,507
Occupancy, office furniture and equipment	3,112	3,856	-	6,968
FDIC insurance premiums	3,390	-	-	3,390
Real estate owned	8,746	-	-	8,746
Other	4,728	14,517	282	19,527
Total noninterest expenses	33,400	69,121	(383)	102,138
Income before income taxes (benefit)	2,582	19,243	885	22,710
Income taxes (benefit)	(19,347)	7,724	(581)	(12,204)
Net income	$ 21,929	11,519	1,466	34,914
Total Assets	$ 1,589,314	147,699	(75,937)	1,661,076

	As of or for the Year ended December 31, 2011			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(in thousands)			
Net interest income	$ 45,611	406	499	46,516
Provision for loan losses	21,960	117	-	22,077
Net interest income after provision for loan losses	23,651	289	499	24,439
Noninterest income	2,431	40,798	-	43,229
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	13,006	26,929	(776)	39,159
Occupancy, office furniture and equipment	3,262	3,226	-	6,488
FDIC insurance premiums	3,814	-	-	3,814
Real estate owned	12,140	-	-	12,140
Other	4,598	7,883	497	12,978
Total noninterest expenses	36,820	38,038	(279)	74,579
Income (loss) before income taxes (benefit)	(10,738)	3,049	778	(6,911)
Income taxes (benefit)	(833)	1,395	–	562
Net income (loss)	$ (9,905)	1,654	778	(7,473)
Total Assets	$ 1,669,231	100,177	(56,557)	1,712,851

Waterstone Financial, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
Years Ended December 31, 2012, 2011 and 2010

	As of or for the Year ended December 31, 2010			
	Community Banking	Mortgage Banking	Holding Company and Other	Consolidated
	(in thousands)			
Net interest income	$ 48,521	641	502	49,664
Provision for loan losses	25,553	279	-	25,832
Net interest income after provision for loan losses	22,968	362	502	23,832
Noninterest income	3,295	35,698	-	38,993
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	13,600	23,478	(755)	36,323
Occupancy, office furniture and equipment	3,313	2,449	-	5,762
FDIC insurance premiums	4,353	-	-	4,353
Real estate owned	6,583	-	-	6,583
Other	5,251	6,034	321	11,606
Total noninterest expenses	33,100	31,961	(434)	64,627
Income (loss) before income taxes (benefit)	(6,837)	4,099	936	(1,802)
Income taxes (benefit)	(1,554)	1,606	–	52
Net income (loss)	$ (5,283)	2,493	936	(1,854)
Total Assets	$ 1,770,912	108,928	(70,874)	1,808,966

<u>Item 9.</u> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>

None

<u>Item 9A</u>. <u>Controls and Procedures</u>

<u>Disclosure Controls and Procedures</u>: Waterstone Financial management, with the participation of Waterstone Financial's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Waterstone Financial's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, Waterstone Financial's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, Waterstone Financial's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by Waterstone Financial in the reports that it files or submits under the Exchange Act.

<u>Change in Internal Control Over Financial Reporting</u>: There have not been any changes in Waterstone Financial's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the final fiscal quarter of the period to which this report relates that have materially affected, or are reasonably likely to materially affect, Waterstone Financial's internal control over financial reporting.

Management's Annual Report on Internal Control Over Financial Reporting

Management of Waterstone Financial Inc. (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

As of December 31, 2012, management assessed the effectiveness of the Company's internal control over financial reporting based on criteria for effective internal control over financial reporting established in "Internal Control—Integrated Framework," issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2012 is effective.

KPMG LLP, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued a report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2012. The report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2012, is included below under the heading "Report of Independent Registered Public Accounting Firm."

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Waterstone Financial, Inc.:

We have audited Waterstone Financial, Inc's internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Waterstone Financial, Inc's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Waterstone Financial, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial condition of Waterstone Financial, Inc and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012 and our report dated March 15, 2013 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Milwaukee, Wisconsin
March 15, 2013

Item 9B. Other Information.

None

Part III

Item 10. Directors, Executive Officers and Corporate Governance

The information in the Company's definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning directors of the Company under the caption "Election of Directors" and compliance with Section 16 reporting requirements under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" and information concerning executive officers of the Company under the caption "Executive Officers of Waterstone Financial" and information concerning corporate governance under the caption "Other Board and Corporate Governance Matters" in Part I hereof is incorporated herein by reference.

Executive Officers of the Registrant

The table below sets forth certain information regarding the persons who have been determined, by our board of directors, to be executive officers of the Company. The executive officers of the Company are elected annually and hold office until their respective successors have been elected or until death, resignation, retirement or removal by the Board of directors.

Name and Age	Offices and Positions with Waterstone Financial and Subsidiaries*	Executive Officer Since
Douglas S. Gordon, 55	Chief Executive Officer and President of Waterstone Financial and of WaterStone Bank	2005
Richard C. Larson, 55	Chief Financial Officer and Senior Vice President of Waterstone Financial and of WaterStone Bank	1990 (1)
William F. Bruss, 43	General Counsel, Senior Vice President and Secretary of Waterstone Financial and of WaterStone Bank	2005
Rebecca M. Arndt, 45	Vice President – Retail Operations of WaterStone Bank	2006
Eric J. Egenhoefer, 37	President of Waterstone Mortgage Corporation	2008

* Excluding directorships and excluding positions with Bank subsidiary which do not constitute a substantial part of the officers' duties.

(1) Indicates date when individual first held an executive officer position with the Bank. This individual became an executive officer of Waterstone Financial upon its organization.

Item 11. Executive Compensation

The information in the Company's definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning this item under the captions "Executive Compensation," "Director Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Discussion and Analysis" is incorporated herein by reference.

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

The information in the Company's definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning this item under the caption "Stock Ownership of Certain Beneficial Owners" is incorporated herein by reference.

Compensation Plans

Set forth below is information as of December 31, 2012 regarding equity compensation plans that have been approved by shareholders. The Company has no equity based benefit plans, other than its employee stock ownership plan, that were not approved by shareholders.

Plan	Number of shares to be issued upon exercise of outstanding options and rights	Weighted average option exercise price	Number of securities remaining available for issuance under plan
2006 Equity Incentive Plan	1,494,298 (1)	$13.11	122,098

(1) Consists of 1,067,356 shares reserved for grants of stock options and 426,942 shares reserved for grants of restricted stock. On December 31, 2012, 1,020,500 options were outstanding with a weighted average exercise price of $13.11 of which 744,500 were exercisable as of that date.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information in the Company's definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning this item under the captions "Certain Transactions with the Company" and "Board Meetings and Committee" is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information in the Company's definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning this item under the caption "Independent Registered Public Accounting Firm," is incorporated herein by reference.

Part IV

<u>Item 15</u>. <u>Exhibits and Financial Statement Schedules</u>

(a) Documents filed as part of the Report:
1. and 2. Financial Statements and Financial Statement Schedules.

The following consolidated financial statements of Waterstone Financial, Inc. and subsidiaries are filed as part of this report under Item 8, "Financial Statements and Supplementary Data":

Consolidated Statements of Financial Condition – December 31, 2012 and 2011.

Consolidated Statements of Operations – Years ended December 31, 2012, 2011 and 2010.

Consolidated Statements of Comprehensive Income (Loss) – Years ended December 31, 2012, 2011 and 2010.

Consolidated Statements of Changes in Shareholders' Equity – Years ended December 31, 2012, 2011 and 2010.

Consolidated Statements of Cash Flows – Years ended December 31, 2012, 2011 and 2010.

Notes to Consolidated Financial Statements.

Report of KPMG LLP, Independent Registered Public Accounting Firm, on consolidated financial statements.

All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

(b). Exhibits. See Exhibit Index following the signature page of this report, which is incorporated herein by reference. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report is identified in the Exhibit Index by an asterisk following its exhibit number.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

WATERSTONE FINANCIAL, INC.

March 15, 2013

By: /s/Douglas S. Gordon
Douglas S. Gordon
Chief Executive Officer

POWER OF ATTORNEY

Each person whose signature appears below hereby authorizes Douglas S. Gordon, Richard C. Larson and William F. Bruss, or any of them, as attorneys-in-fact with full power of substitution, to execute in the name and on behalf of such person, individually, and in each capacity stated below or otherwise, and to file, any and all amendments to this report.

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

Signature and Title

/s/Douglas S. Gordon Douglas S. Gordon, *Chief Executive Officer and Director* *(Principal Executive Officer)*	/s/Patrick S. Lawton Patrick S. Lawton, *Chairman and Director*
/s/Richard C. Larson Richard C. Larson, *Senior Vice President* *Chief Financial Officer* *(Principal Financial and Accounting Officer)*	/s/Thomas E. Dalum Thomas E. Dalum, *Director*
	/s/Michael L. Hansen Michael L. Hansen, *Director*
	/s/Stephen J. Schmidt Stephen J. Schmidt, *Director*

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*Each of the above signatures is affixed as of March 15, 2013.

WATERSTONE FINANCIAL, INC
(“Waterstone Financial” or the “Company”)
Commission File No. 000-51507

EXHIBIT INDEX
TO
2012 REPORT ON FORM 10-K

The following exhibits are filed with, or incorporated by reference in, this Annual Report on Form 10-K for the year ended December 31, 2012:

Exhibit	Description	Incorporated Herein By Reference To	Filed Herewith
2.1	Plan of Reorganization from Mutual Savings Bank to Mutual Holding Company of Wauwatosa Savings Bank (the “Bank”), as adopted on May 17,2005 and amended on June 3, 2005 (the “Plan”)	Exhibit 2.1 to the Company’s Registration Statement on Form S-1, Registration No. 333-125715 (the “2005 S-1”)	
3.1	Articles of Incorporation of the Company	Exhibit 3.1 to 2005 S-1	
3.2	Proposed Bylaws of the Company	Exhibit 3.1 to 2005 S-1	
10.4*	Stock Compensation Plans	Exhibit 10.1 to the company’s Current Report on Form 8-K filed on May 22, 2006	
11.1	Statement re: Computation of Per Share Earnings	See Note 16 in Part II Item 8	
21.1	List of Subsidiaries		X
23.1	Consent of Independent Registered Public Accounting Firm		X
24.1	Powers of Attorney	Signature Page	
31.1	Sarbanes-Oxley Act Section 302 Certification signed by the Chief Executive Officer of Waterstone Financial		X
31.2	Sarbanes-Oxley Act Section 302 Certification signed by the Chief Financial Officer of Waterstone Financial		X
32.1	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Executive Officer of Waterstone Financial		X

Exhibit	Description	Incorporated Herein By Reference To	Filed Herewith
32.2	Certification pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Financial Officer of Waterstone Financial		X

* Designates management or compensatory agreements, plans or arrangements required to be filed as exhibits pursuant to Item 15(b) of Form 10-K.

Exhibit 21.1

The following table sets forth the name and jurisdiction of incorporation/charter of the Company's subsidiaries as of December 31, 2012. Inactive subsidiaries are not listed. All of the subsidiaries are 100% owned.

Name of Subsidiary	Jurisdiction of Incorporation/Charter
WaterStone Bank, SSB (1)	Wisconsin
Wauwatosa Investments, Inc. (2)	Nevada
Waterstone Mortgage Corporation (2)	Wisconsin

(1) Direct subsidiary of Waterstone Financial, Inc.
(2) Direct subsidiary of WaterStone Bank

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Waterstone Financial, Inc

We consent to the incorporation by reference in the Registration Statement (No. 333-125715) on Form S-8 of Waterstone Financial, Inc. and subsidiaries of our reports dated March 15, 2013, with respect to the consolidated statements of financial condition of Waterstone Financial, Inc. and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012, and the effectiveness of internal control over financial reporting as of December 31, 2012, which reports appear in the December 31, 2012 annual report on Form 10-K of Waterstone Financial, Inc.

/s/ KPMG LLP

Milwaukee, Wisconsin
March 15, 2013

Exhibit 31.1

CERTIFICATION

I, Douglas S. Gordon, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2012 of Waterstone Financial, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2013

/s/ Douglas S. Gordon
Douglas S. Gordon,
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Richard C. Larson, certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2012 of Waterstone Financial, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2013

/s/ Richard C. Larson
Richard C. Larson,
Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Waterstone Financial, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Douglas S. Gordon, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Douglas S. Gordon
Douglas S. Gordon
Chief Executive Officer
March 15, 2013

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Waterstone Financial, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Richard C. Larson, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard C. Larson
Richard C. Larson
Chief Financial Officer
March 15, 2013

WATERSTONE FINANCIAL, INC. -DIRECTORS

PATRICK S. LAWTON
Chairman of the Board

THOMAS E. DALUM

DOUGLAS S. GORDON

MICHAEL L. HANSEN

STEPHEN J. SCHMIDT

WATERSTONE FINANCIAL, INC. -OFFICERS

DOUGLAS S. GORDON
Chief Executive Officer & President

WILLIAM F. BRUSS
General Counsel, Secretary & Senior Vice President

RICHARD C. LARSON
Chief Financial Officer, Treasurer & Senior Vice President

AS OF MARCH 2013

Waterstone FINANCIAL, INC.

WATERSTONE BANK SSB

Waterstone MORTGAGE

WATERSTONE BANK SSB -OFFICERS

DOUGLAS S. GORDON
Chief Executive Officer & President

WILLIAM F. BRUSS
General Counsel, Secretary & Senior Vice President

RICHARD C. LARSON
Chief Financial Officer, Treasurer & Senior Vice President

DON BRAY
Chief Information Officer & Vice President

DAVE PROVANCHER
Chief Credit Officer & Vice President

REBECCA M. ARNDT
Vice President

ANDREW BOARIO
Vice President

JAMES CROWLEY
Vice President

TODD M. CRUCIANI
Vice President

MICHAEL GRIEBEL
Vice President

EDWARD ROESSEL
Vice President

KENNETH A. SNYDER
Vice President

JULIE FAY-KRIVITZ
Assistant Vice President

JUDY L. GEBHARD
Assistant Vice President

MARK R. GERKE
Corporate Controller

MARGARET HAAGENSEN
Assistant Vice President

JODI L. JOHNSON
Assistant Vice President

JACK KAHL
Assistant Vice President

COLLETTE M. KENDZIERSKI
Assistant Vice President

IAN KONRATH
Assistant Vice President

MEGAN MCCOY
Assistant Vice President

SALLY MCFADDEN
Assistant Vice President

THERESE M. PEKAR
Assistant Vice President

MARK VAP
Assistant Vice President

JUDY M. WAGNER
Assistant Controller

RYAN DEUTSCHER
Community President, Germantown/Menomonee Falls

ROBIN KAUFMANN
Community President, Pewaukee

ERIN MCCARTHY
Community President, Wauwatosa

MIGUEL OCAMPO
Community President, Waukesha/Brookfield

GINA RAFENSTEIN
Community President, West Allis

WENDY RICE
Community President, Oak Creek

MARY SCHALIG
Community President, Oconomowoc/Lake Country

LATRICE YOUNG
Community President, Franklin/Hales Corners

WATERSTONE MORTGAGE CORPORATION -OFFICERS

ERIC J. EGENHOEFER
President

KPMG, LLP
Auditors

Waterstone FINANCIAL, INC.

CORPORATE CENTER
11200 West Plank Court
Wauwatosa WI 53226

WATERSTONE BANK SSB

WAUWATOSA
75th & State Street

FRANKLIN/HALES CORNERS
Hwy 100 & Speedway Drive

GERMANTOWN/MENOMONEE FALLS
Appleton Ave & Maple Road

OAK CREEK
27th & College Avenue

OCONOMOWOC/LAKE COUNTRY
Hwy 67 & I-94

PEWAUKEE
Hwy 16 & Capitol Drive

WAUKESHA/BROOKFIELD
Hwy 18 & I-94

WEST ALLIS
I-894 & Greenfield Avenue

Waterstone MORTGAGE

CORPORATE OFFICE
1133 Quail Court
Pewaukee, WI 53072