

Waterstone Financial, Inc.  
Form 424B3  
November 22, 2013

**Filed pursuant to Rule 424(b)(3)**

**Registration Statement No. 333-189160**

Dear Fellow Stockholder:

Waterstone Financial, Inc. is soliciting stockholder votes regarding the mutual-to-stock conversion of Lamplighter Financial, MHC. Pursuant to a Plan of Conversion and Reorganization, our organization will convert from a partially public company to a fully public company by selling a minimum of 18,700,000 shares of common stock of a newly formed company, also named Waterstone Financial, Inc. (“New Waterstone”), which will become the holding company for WaterStone Bank SSB.

**The Proxy Vote**

We have received regulatory approval of the application that includes the Plan of Conversion and Reorganization. However, we must also receive the approval of our stockholders. Enclosed is a proxy statement/prospectus describing the proposals being presented at our special meeting of stockholders. Please promptly vote the enclosed proxy card. Our Board of Directors urges you to vote “FOR” the approval of the Plan of Conversion and Reorganization and “FOR” the other matters being presented at the special meeting.

**The Exchange**

At the conclusion of the conversion, your shares of Waterstone Financial, Inc. common stock will be exchanged for shares of New Waterstone common stock. The number of new shares that you receive will be based on an exchange ratio that is described in the proxy statement/prospectus. Shortly after the completion of the conversion, our exchange agent will send a transmittal form to each stockholder of Waterstone Financial, Inc. who holds stock certificates. The transmittal form explains the procedure to follow to exchange your shares. Please do not deliver your certificate(s) before you receive the transmittal form. Shares of Waterstone Financial, Inc. that are held in street name (e.g., in a brokerage account) will be converted automatically at the conclusion of the conversion; no action or documentation is required of you.

**The Stock Offering**

We are offering the shares of common stock of New Waterstone for sale at \$10.00 per share. The shares are first being offered in a subscription offering to eligible depositors of WaterStone Bank SSB. If all shares are not subscribed for in the subscription offering, shares would be available in a community offering to Waterstone Financial, Inc. public stockholders and others not eligible to place orders in the subscription offering. If you may be interested in purchasing shares of our common stock, contact our Stock Information Center at (414) 459-4700 to receive a stock order form and prospectus. The stock offering period is expected to expire on December 17, 2013.

If you have any questions, please refer to the Questions & Answers section herein.

We thank you for your support as a stockholder of Waterstone Financial, Inc.

Sincerely,

Douglas S. Gordon  
President and Chief Executive Officer

These securities are not deposits or savings accounts and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. None of the Securities and Exchange Commission, the Board of Governors of the Federal Reserve System, or any state securities regulator has approved or disapproved of these securities or determined if this proxy statement/prospectus is accurate or complete. Any representation to the contrary is a criminal offense.

PROSPECTUS OF WATERSTONE FINANCIAL, INC., A MARYLAND CORPORATION  
PROXY STATEMENT OF WATERSTONE FINANCIAL, INC., A FEDERAL CORPORATION

WaterStone Bank SSB, which we sometimes refer to in this document as “WaterStone Bank,” is converting from the mutual holding company structure to a fully-public stock holding company structure. Currently, WaterStone Bank is a wholly-owned subsidiary of Waterstone Financial, Inc., a federally chartered corporation, which we sometimes refer to in this document as “Waterstone-Federal,” and Lamplighter Financial, MHC owns 73.5% of Waterstone Financial, Inc.’s common stock. The remaining 26.5% of Waterstone Financial, Inc.’s common stock is owned by public stockholders. As a result of the conversion, a newly formed Maryland corporation named Waterstone Financial, Inc. (“New Waterstone”) will replace Waterstone Financial, Inc. as the holding company of WaterStone Bank. Each share of Waterstone Financial, Inc. common stock owned by the public will be exchanged for between 0.8111 and 1.0973 shares of common stock of New Waterstone, so that immediately after the conversion Waterstone Financial, Inc.’s existing public stockholders will own the same percentage of New Waterstone common stock as they owned of Waterstone Financial, Inc.’s common stock immediately prior to the conversion, excluding any new shares purchased by them in the offering and their receipt of cash in lieu of fractional exchange shares. The actual number of shares that you will receive will depend on the percentage of Waterstone Financial, Inc. common stock held by the public at the completion of the conversion, the final independent appraisal of New Waterstone and the number of shares of New Waterstone common stock sold in the offering described in the following paragraph. It will not depend on the market price of Waterstone Financial, Inc. common stock. See “Proposal 1—Approval of the Plan of Conversion and Reorganization—Share Exchange Ratio” for a discussion of the exchange ratio. Based on the \$10.64 per share closing price of Waterstone Financial, Inc. common stock as of the last trading day prior to the date of this proxy statement/prospectus, unless at least 24,531,544 shares of New Waterstone common stock are sold in the offering (which is between the midpoint and the maximum of the offering range), the initial value of the New Waterstone common stock you receive in the share exchange would be less than the market value of the Waterstone Financial, Inc. common stock you currently own. See “Risk Factors—The market value of New Waterstone common stock received in the share exchange may be less than the market value of Waterstone Financial, Inc. common stock exchanged.”

Concurrently with the exchange offer, we are offering for sale up to 25,300,000 shares of common stock of New Waterstone, representing the ownership interest of Lamplighter Financial, MHC in Waterstone Financial, Inc. We are offering the shares of common stock to eligible depositors of WaterStone Bank, to WaterStone Bank’s tax qualified benefit plans and to the public, including Waterstone Financial, Inc. stockholders, at a price of \$10.00 per share. The conversion of Lamplighter Financial, MHC and the offering and exchange of common stock by New Waterstone is referred to herein as the “conversion and offering.” After the conversion and offering are completed, WaterStone Bank will be a wholly-owned subsidiary of New Waterstone, and 100% of the common stock of New Waterstone will be owned by public stockholders. As a result of the conversion and offering, Waterstone Financial, Inc., the federal corporation, and Lamplighter Financial, MHC will cease to exist.

Waterstone Financial, Inc.’s common stock is currently traded on the Nasdaq Global Select Market under the trading symbol “WSBF,” and we expect New Waterstone’s shares of common stock will also trade on the Nasdaq Global Select Market under the symbol “WSBF.”

The conversion and offering cannot be completed unless the stockholders of Waterstone Financial, Inc. approve the Plan of Conversion and Reorganization of Lamplighter Financial, MHC, which may be referred to herein as the “plan of conversion.” Waterstone Financial, Inc. is holding a special meeting of stockholders at 11200 West Plank Court, Wauwatosa, Wisconsin, on December 27, 2013, at 11:00 a.m., Central Time, to consider and vote upon the plan of conversion. We must obtain the affirmative vote of the holders of (i) two-thirds of the total number of votes entitled

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to be cast at the special meeting by Waterstone Financial, Inc. stockholders, including shares held by Lamplighter Financial, MHC, and (ii) a majority of the total number of votes entitled to be cast at the special meeting by Waterstone Financial, Inc. stockholders other than Lamplighter Financial, MHC. Waterstone Financial, Inc.'s board of directors unanimously recommends that stockholders vote "FOR" the plan of conversion.

This document serves as the proxy statement for the special meeting of stockholders of Waterstone Financial, Inc. and the prospectus for the shares of New Waterstone common stock to be issued in exchange for shares of Waterstone Financial, Inc. common stock. We urge you to read this entire document carefully. You can

also obtain information about us from documents that we have filed with the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System. This document does not serve as the prospectus relating to the offering by New Waterstone of its shares of common stock in the offering, which is being made pursuant to a separate prospectus. Stockholders of Waterstone Financial, Inc. are not required to participate in the stock offering.

This proxy statement/prospectus contains information that you should consider in evaluating the plan of conversion. In particular, you should carefully read the section captioned "Risk Factors" beginning on page 21 for a discussion of certain risk factors relating to the conversion and offering.

These securities are not deposits or savings accounts and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

None of the Securities and Exchange Commission, the Board of Governors of the Federal Reserve System, the Wisconsin Department of Financial Institutions or any state securities regulator has approved or disapproved of these securities or determined if this proxy statement/prospectus is accurate or complete. Any representation to the contrary is a criminal offense.

For answers to your questions, please read this proxy statement/prospectus including the Questions and Answers section, beginning on page 1. Questions about voting on the plan of conversion may be directed to AST Phoenix Advisors, at (800) 283-8518, Monday through Friday from 9:00 a.m. to 10:00 p.m., Eastern Time, and Saturdays from 10:00 a.m. to 6:00 p.m., Eastern Time.

The date of this proxy statement/prospectus is November 6, 2013, and it is first being mailed to stockholders of Waterstone Financial, Inc. on or about November 19, 2013.

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

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

On December 27, 2013, Waterstone Financial, Inc. will hold a special meeting of stockholders at 11200 West Plank Court, Wauwatosa, Wisconsin. The meeting will begin at 11:00 a.m., Central Time. At the meeting, stockholders will consider and act on the following:

1. The approval of a plan of conversion and reorganization, whereby Lamplighter Financial, MHC and Waterstone Financial, Inc., a federal corporation, will convert and reorganize from the mutual holding company structure to the stock holding company structure, as more fully described in the attached proxy statement;
2. The approval of the adjournment of the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the plan of conversion and reorganization;

The following informational proposals:

3. Approval of a provision in New Waterstone's articles of incorporation requiring a super-majority vote of stockholders to approve certain amendments to New Waterstone's articles of incorporation;
4. Approval of a provision in New Waterstone's articles of incorporation requiring a super-majority vote of stockholders to approve stockholder-proposed amendments to New Waterstone's bylaws;
5. Approval of a provision in New Waterstone's articles of incorporation to limit the voting rights of shares beneficially owned in excess of 10% of New Waterstone's outstanding voting stock; and

Such other business that may properly come before the meeting.

NOTE: The board of directors is not aware of any other business to come before the meeting.

The provisions of New Waterstone's articles of incorporation that are summarized as informational proposals 3 through 5 were approved as part of the process in which our board of directors approved the plan of conversion and reorganization (referred to herein as the "plan of conversion"). These proposals are informational in nature only because the Board of Governors of the Federal Reserve System's regulations governing mutual-to-stock conversions do not provide for votes on matters other than the plan of conversion. While we are asking you to vote with respect to each of the informational proposals listed above, the proposed provisions for which an informational vote is requested will become effective if stockholders approve the plan of conversion, regardless of whether stockholders vote to approve any or all of the informational proposals.

The board of directors has fixed October 31, 2013, as the record date for the determination of stockholders entitled to notice of and to vote at the special meeting and at any adjournment or postponement thereof.

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Upon written request addressed to the Corporate Secretary of Waterstone Financial, Inc. at the address given above, stockholders may obtain an additional copy of this proxy statement/prospectus and/or a copy of the plan of conversion. In order to assure timely receipt of the additional copy of the proxy statement/prospectus and/or the plan of conversion, the written request should be received by Waterstone Financial, Inc. by December 13, 2013.

Please complete and sign the enclosed proxy card, which is solicited by the board of directors, and mail it promptly in the enclosed envelope. The proxy will not be used if you attend the meeting and vote in person.

BY ORDER OF THE BOARD OF DIRECTORS

William F. Bruss  
Corporate Secretary

Wauwatosa, Wisconsin  
November 6, 2013



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QUESTIONS AND ANSWERS  
FOR STOCKHOLDERS OF WATERSTONE FINANCIAL, INC.  
REGARDING THE PLAN OF CONVERSION AND REORGANIZATION

You should read this document for more information about the conversion. The application that includes the plan of conversion described herein has been approved by Waterstone Financial, Inc.'s primary federal regulator, the Board of Governors of the Federal Reserve System. However, such approval by the Board of Governors of the Federal Reserve System does not constitute a recommendation or endorsement of the plan of conversion.

**Q. WHAT ARE STOCKHOLDERS BEING ASKED TO APPROVE?**

A. Waterstone Financial, Inc. stockholders as of October 31, 2013 are being asked to vote on the plan of conversion pursuant to which Lamplighter Financial, MHC will convert from the mutual to the stock form of organization. As part of the conversion, a newly formed Maryland corporation, New Waterstone, is offering its common stock to eligible depositors of WaterStone Bank, to WaterStone Bank's tax qualified benefit plans, to stockholders of Waterstone Financial, Inc. as of October 31, 2013 and to the public. The shares offered represent Lamplighter Financial, MHC's current ownership interest in Waterstone Financial, Inc. Voting for approval of the plan of conversion will also include approval of the exchange ratio and the articles of incorporation of New Waterstone (including the anti-takeover provisions and provisions limiting stockholder rights). Your vote is important. Without sufficient votes "FOR" its adoption, we cannot implement the plan of conversion and complete the stock offering.

In addition, Waterstone Financial, Inc. stockholders are being asked to approve the adjournment of the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the plan of conversion.

Stockholders also are asked to vote on the following informational proposals with respect to the articles of incorporation of New Waterstone:

Approval of a provision requiring a super-majority vote to approve certain amendments to New Waterstone's articles of incorporation;

Approval of a provision requiring a super-majority vote of stockholders to approve stockholder-proposed amendments to New Waterstone's bylaws; and

Approval of a provision to limit the voting rights of shares beneficially owned in excess of 10% of New Waterstone's outstanding voting stock.

The provisions of New Waterstone's articles of incorporation that are included as informational proposals were approved as part of the process in which our board of directors approved the plan of conversion. These proposals are informational in nature only, because the Board of Governors of the Federal Reserve System's regulations governing mutual-to-stock conversions do not provide for votes on matters other than the plan of conversion. While we are asking you to vote with respect to each of the informational proposals listed above, the proposed provisions for which an informational vote is requested will become effective if stockholders approve the plan of conversion, regardless of whether stockholders vote to approve any or all of the informational proposals. The provisions of New Waterstone's articles of incorporation that are summarized above as informational proposals may have the effect of deterring, or rendering more difficult, attempts by third parties to obtain control of New Waterstone if such attempts are not approved by the board of directors, or may make the removal of the board of directors or management, or the

appointment of new directors, more difficult.

Your vote is important. Without sufficient votes “FOR” adoption of the plan of conversion, we cannot implement the plan of conversion and the related stock offering.

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Q. WHAT ARE THE REASONS FOR THE CONVERSION AND RELATED OFFERING?

A. The primary reasons for the conversion and offering are to:

eliminate some of the uncertainties associated with the mutual holding company structure under financial reform legislation;

transition us to a more familiar and flexible organizational structure;

enhance our regulatory capital position;

improve the liquidity of our shares of common stock; and

facilitate future mergers and acquisitions.

As a fully converted stock holding company, we will have greater flexibility in structuring mergers and acquisitions, including the form of consideration that we can use to pay for an acquisition. Our current mutual holding company structure limits our ability to offer shares of our common stock as consideration in a merger or acquisition since Lamplighter Financial, MHC is required to own a majority of Waterstone Financial, Inc.'s outstanding shares of common stock. Potential sellers often want stock for at least part of the purchase price. Our new stock holding company structure will enable us to offer stock or cash consideration, or a combination of stock and cash, and therefore will enhance our ability to compete with other bidders when acquisition opportunities arise. We currently have no arrangements or understandings regarding any specific acquisition.

Q. WHAT WILL STOCKHOLDERS RECEIVE FOR THEIR EXISTING WATERSTONE FINANCIAL, INC. SHARES?

A. As more fully described in "Proposal 1 — Approval of the Plan of Conversion and Reorganization — Share Exchange Ratio," depending on the number of shares sold in the offering, each share of common stock that you own at the time of the completion of the conversion will be exchanged for between 0.8111 shares at the minimum and 1.0973 shares at the maximum of the offering range of New Waterstone common stock (cash will be paid in lieu of any fractional shares). For example, if you own 100 shares of Waterstone Financial, Inc. common stock, and the exchange ratio is 1.0973 (at the maximum of the offering range), after the conversion you will receive 109 shares of New Waterstone common stock and \$7.30 in cash, the value of the fractional share based on the \$10.00 per share purchase price of stock in the offering.

If you own shares of Waterstone Financial, Inc. common stock in a brokerage account in "street name," your shares will be automatically exchanged within your account, and you do not need to take any action to exchange your shares of common stock or receive cash in lieu of fractional shares. If you own shares in the form of Waterstone Financial, Inc. stock certificates, after the completion of the conversion and stock offering, our exchange agent will mail to you a transmittal form with instructions to surrender your stock certificates. A statement reflecting your ownership of shares of common stock of New Waterstone and a check representing cash in lieu of fractional shares will be mailed to you within five business days after the transfer agent receives a properly executed transmittal form and your existing Waterstone Financial, Inc. stock certificate(s). New Waterstone will not issue stock certificates. You should not submit a stock certificate until you receive a transmittal form.

**Q. WHY WILL THE SHARES THAT I RECEIVE BE BASED ON A PRICE OF \$10.00 PER SHARE RATHER THAN THE TRADING PRICE OF THE COMMON STOCK PRIOR TO COMPLETION OF THE CONVERSION?**

A. The shares will be based on a price of \$10.00 per share because that is the price at which New Waterstone will sell shares in its stock offering. The amount of common stock New Waterstone will issue at \$10.00 per share in the offering and the exchange is based on an independent appraisal of the estimated market value of New Waterstone, assuming the conversion and offering are completed. RP Financial, LC., an appraisal firm experienced in the appraisal of financial institutions, has estimated that, as of July 19, 2013, this market value was \$299.2 million. Based on Board of Governors of the Federal Reserve System regulations, the market value forms the midpoint of a range with a minimum of \$254.3 million and a maximum of \$344.1 million. Based on this valuation and the valuation range, the number of shares of common stock of New Waterstone that existing public stockholders of Waterstone Financial, Inc. will receive in exchange for their shares of Waterstone Financial, Inc. common stock is expected to range from 6,731,209 to 9,106,929 with a midpoint of 7,919,069 (a value of approximately \$67.3 million to \$91.1 million, with a midpoint of \$79.2 million, at \$10.00 per share). The number of shares received by the existing public stockholders of Waterstone Financial, Inc. is intended to maintain their existing ownership in our organization (excluding any new shares purchased by them in the offering and their receipt of cash in lieu of fractional exchange shares). The independent appraisal is based in part on Waterstone Financial, Inc.'s financial condition and results of operations, the pro forma impact of the additional capital raised by the sale of shares of common stock in the offering, and an analysis of a peer group of ten publicly traded savings bank and thrift holding companies that RP Financial, LC. considered comparable to Waterstone Financial, Inc.

**Q. DOES THE EXCHANGE RATIO DEPEND ON THE TRADING PRICE OF WATERSTONE FINANCIAL, INC. COMMON STOCK?**

A. No, the exchange ratio will not be based on the market price of Waterstone Financial, Inc. common stock. Instead, the exchange ratio will be based on the appraised value of New Waterstone. The purpose of the exchange ratio is to maintain the ownership percentage of existing public stockholders of Waterstone Financial, Inc. Therefore, changes in the price of Waterstone Financial, Inc. common stock between now and the completion of the conversion and offering will not affect the calculation of the exchange ratio.

**Q. SHOULD I SUBMIT MY STOCK CERTIFICATES NOW?**

A. No. If you hold stock certificate(s), instructions for exchanging the certificates will be sent to you by our exchange agent after completion of the conversion. If your shares are held in "street name" (e.g., in a brokerage account) rather than in certificate form, the share exchange will be reflected automatically in your account upon completion of the conversion.

**Q. HOW DO I VOTE?**

A. Mark your vote, sign each proxy card enclosed and return the card(s) to us, in the enclosed proxy reply envelope. For information on submitting your proxy, please refer to instructions on the enclosed proxy card. **YOUR VOTE IS IMPORTANT. PLEASE VOTE PROMPTLY.**

**Q. IF MY SHARES ARE HELD IN STREET NAME, WILL MY BROKER, BANK OR OTHER NOMINEE AUTOMATICALLY VOTE ON THE PLAN ON MY BEHALF?**

A.No. Your broker, bank or other nominee will not be able to vote your shares without instructions from you. You should instruct your broker, bank or other nominee to vote your shares, using the directions that they provide to you.

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Q. WHY SHOULD I VOTE? WHAT HAPPENS IF I DON'T VOTE?

A. Your vote is very important. We believe the conversion and offering are in the best interests of our stockholders. Not voting all the proxy card(s) you receive will have the same effect as voting "against" the plan of conversion. Without sufficient favorable votes "for" the plan of conversion, we cannot complete the conversion and offering.

Q. WHAT IF I DO NOT GIVE VOTING INSTRUCTIONS TO MY BROKER, BANK OR OTHER NOMINEE?

A. Your vote is important. If you do not instruct your broker, bank or other nominee to vote your shares, the unvoted proxy will have the same effect as a vote "against" the plan of conversion.

Q. MAY I PLACE AN ORDER TO PURCHASE SHARES IN THE COMMUNITY OFFERING, IN ADDITION TO THE SHARES THAT I WILL RECEIVE IN THE EXCHANGE?

A. Yes. If you would like to receive a prospectus and stock order form, you must call our Stock Information Center at (414) 459-4700, Monday through Friday between 10:00 a.m. and 4:00 p.m., Central Time. The Stock Information Center is closed weekends and bank holidays.

Eligible depositors of WaterStone Bank have priority subscription rights allowing them to purchase common stock in a subscription offering. Shares not purchased in the subscription offering may be available for sale to the public in a community offering, as described herein. In the event orders for New Waterstone common stock in a community offering exceed the number of shares available for sale, shares may be allocated (to the extent shares remain available) first to cover orders of natural persons residing in Milwaukee, Washington and Waukesha Counties, Wisconsin; second to cover orders of Waterstone Financial, Inc. stockholders as of October 31, 2013; and thereafter to cover orders of the general public.

Stockholders of Waterstone Financial, Inc. are subject to an ownership limitation. Shares of common stock purchased in the offering by a stockholder and his or her associates or individuals acting in concert with the stockholder, plus any shares a stockholder and these individuals receive in the exchange for existing shares of Waterstone Financial, Inc. common stock, may not exceed 9.9% of the total shares of common stock of New Waterstone to be issued and outstanding after the completion of the conversion.

Please note that properly completed and signed stock order forms, with full payment, must be received (not postmarked) no later than 5:00 p.m., Central Time on December 17, 2013.

Q. WILL THE CONVERSION HAVE ANY EFFECT ON DEPOSIT AND LOAN ACCOUNTS AT WATERSTONE BANK?

A. No. The account number, amount, interest rate and withdrawal rights of deposit accounts will remain unchanged. Deposits will continue to be federally insured by the Federal Deposit Insurance Corporation up to the legal limit. Loans and rights of borrowers will not be affected. Depositors will no longer have voting rights in Lamplighter Financial, MHC as to matters currently requiring such vote. Lamplighter Financial, MHC will cease to exist after the conversion and offering. Only stockholders of New Waterstone will have voting rights after the conversion and offering.

OTHER QUESTIONS?



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For answers to other questions, please read this proxy statement/prospectus. Questions about voting on the plan of conversion may be directed to AST Phoenix Advisors, at (800) 283-8518, Monday through Friday from 9:00 a.m. to 10:00 p.m., Eastern Time, and Saturdays from 10:00 a.m. to 6:00 p.m., Eastern Time. Questions about the stock offering may be directed to our Stock Information Center at (414) 459-4700,

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Monday through Friday between 10:00 a.m. and 4:00 p.m., Central Time. The Stock Information Center is closed weekends and bank holidays.

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## SUMMARY

This summary highlights material information from this proxy statement/prospectus and may not contain all the information that is important to you. To understand the conversion and other proposals fully, you should read this entire document carefully, including the sections entitled “Risk Factors,” “Proposal 1 — Approval of The Plan of Conversion and Reorganization,” “Proposal 2 — Adjournment of the Special Meeting,” “Proposals 3 through 5 — Informational Proposals Related to the Articles of Incorporation of New Waterstone” and the consolidated financial statements and the notes to the consolidated financial statements.

### The Special Meeting

**Date, Time and Place.** Waterstone Financial, Inc. will hold its special meeting of stockholders at 11200 West Plank Court, Wauwatosa, Wisconsin, on December 27, 2013, at 11:00 a.m., Central Time.

The Proposals. Stockholders will be voting on the following proposals at the special meeting:

1. The approval of a plan of conversion and reorganization whereby: (a) Lamplighter Financial, MHC and Waterstone Financial, Inc., a federal corporation, will convert and reorganize from the mutual holding company structure to the stock holding company structure; (b) Waterstone Financial, Inc., a Maryland corporation (“New Waterstone”), will become the new stock holding company of WaterStone Bank; (c) the outstanding shares of Waterstone Financial, Inc., other than those held by Lamplighter Financial, MHC, will be converted into shares of common stock of New Waterstone; and (d) New Waterstone will offer shares of its common stock for sale in a subscription offering, a community offering and, if necessary, a syndicated offering;
2. The approval of the adjournment of the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the plan of conversion;

The following informational proposals:

3. Approval of a provision in New Waterstone’s articles of incorporation requiring a super-majority vote of stockholders to approve certain amendments to New Waterstone’s articles of incorporation;
4. Approval of a provision in New Waterstone’s articles of incorporation requiring a super-majority vote of stockholders to approve stockholder-proposed amendments to New Waterstone’s bylaws;
5. Approval of a provision in New Waterstone’s articles of incorporation to limit the voting rights of shares beneficially owned in excess of 10% of New Waterstone’s outstanding voting stock; and

Such other business that may properly come before the meeting.

The provisions of New Waterstone's articles of incorporation that are summarized as informational proposals 3 through 5 were approved as part of the process in which our board of directors approved the plan of conversion. These proposals are informational in nature only, because the Board of Governors of the Federal Reserve System's regulations governing mutual-to-stock conversions do not provide for votes on matters other than the plan of conversion. While we are asking you to vote with respect to each of the informational proposals listed above, the proposed provisions for which an informational vote is requested will become effective if stockholders approve the plan of conversion, regardless of whether stockholders vote to approve any or all of the informational proposals. The provisions of New Waterstone's articles of incorporation that are summarized as informational proposals may have the effect of deterring or rendering more difficult attempts by third parties to obtain control of New Waterstone, if such attempts are not approved by the board of directors, or may make the removal of the board of directors or management, or the appointment of new directors, more difficult.

Vote Required for Approval of Proposals by the Stockholders of Waterstone Financial, Inc.

Proposal 1: Approval of the Plan of Conversion. We must obtain the affirmative vote of the holders of (i) two-thirds of the total number of votes entitled to be cast at the special meeting by Waterstone Financial, Inc. stockholders, including shares held by Lamplighter Financial, MHC, and (ii) a majority of the total number of votes entitled to be cast at the special meeting by Waterstone Financial, Inc. stockholders other than Lamplighter Financial, MHC.

Proposal 1 must also be approved by the members of Lamplighter Financial, MHC (depositors of WaterStone Bank) at a special meeting of members called for that purpose. Members will receive separate informational materials from Lamplighter Financial, MHC regarding the conversion.

Proposal 2: Approval of the adjournment of the special meeting. We must obtain the affirmative vote of at least a majority of the votes cast by Waterstone Financial, Inc. stockholders at the special meeting to adjourn the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the proposal to approve the plan of conversion.

Informational Proposals 3 through 5. The provisions of New Waterstone's articles of incorporation that are summarized as informational proposals were approved as part of the process in which the board of directors of Waterstone Financial, Inc. approved the plan of conversion. These proposals are informational in nature only, because the Board of Governors of the Federal Reserve System's regulations governing mutual-to-stock conversions do not provide for votes on matters other than the plan of conversion. While we are asking you to vote with respect to each of the informational proposals listed above, the proposed provisions for which an informational vote is requested will become effective if stockholders approve the plan of conversion, regardless of whether stockholders vote to approve any or all of the informational proposals. The provisions of New Waterstone's articles of incorporation that are summarized as informational proposals may have the effect of deterring or rendering more difficult attempts by third parties to obtain control of New Waterstone, if such attempts are not approved by the board of directors, or may make the removal of the board of directors or management, or the appointment of new directors, more difficult.

Other Matters. We must obtain the affirmative vote of the majority of the votes cast by holders of outstanding shares of common stock of Waterstone Financial, Inc. At this time, we know of no other matters that may be presented at the special meeting.

Revocability of Proxies

You may revoke your proxy at any time before the vote is taken at the special meeting. To revoke your proxy, you must advise the corporate secretary of Waterstone Financial, Inc. in writing before your common stock has been voted at the special meeting, deliver a later-dated proxy or attend the special meeting and vote your shares in person. Attendance at the special meeting will not in itself constitute revocation of your proxy.

Vote by Lamplighter Financial, MHC

Management anticipates that Lamplighter Financial, MHC, our majority stockholder, will vote all of its shares of common stock in favor of all the matters set forth above. If Lamplighter Financial, MHC votes all of its shares in favor of each proposal, the approval of the adjournment of the special meeting, if necessary, would be assured,

and the approval of the plan of conversion and reorganization by stockholders holding at least two-thirds of the outstanding shares of common stock of Waterstone-Federal, including shares held by Lamplighter Financial, MHC, would also be assured.

As of October 31, 2013 the directors and executive officers of Waterstone Financial, Inc. beneficially owned 1,551,892 shares, or approximately 4.9% of the outstanding shares of Waterstone Financial, Inc. common stock, and Lamplighter Financial, MHC owned 23,050,183 shares, or approximately 73.5% of the outstanding shares of Waterstone Financial, Inc. common stock.

## Vote Recommendations

Your board of directors unanimously recommends that you vote “FOR” the plan of conversion, “FOR” the adjournment of the special meeting, if necessary, and “FOR” the Informational Proposals 3 through 5.

## Our Business

Our business operations are conducted through our wholly-owned subsidiary, WaterStone Bank. WaterStone Bank is a community bank that has served the banking needs of its customers in the metropolitan Milwaukee area and surrounding markets since 1921. WaterStone Bank also has an active mortgage banking subsidiary, Waterstone Mortgage Corporation, which had 71 offices in 14 states as of June 30, 2013.

WaterStone Bank conducts its community banking business from eight banking offices and nine automated teller machines located in Milwaukee, Washington and Waukesha Counties, Wisconsin. In October 2013, WaterStone Bank opened a loan production office in Maple Grove, Minnesota, a part of the greater Minneapolis-St. Paul metropolitan area. WaterStone Bank has also received regulatory approval to open a new full-service banking office in Brookfield, Wisconsin, and expects to open that office in January 2014. WaterStone Bank’s principal lending activity is originating one- to four-family and over four-family, or “multi-family,” residential real estate loans, for retention in its portfolio. At June 30, 2013, such loans comprised 38.5% and 46.9%, respectively, of WaterStone Bank’s loan 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 funds its loan production primarily with retail deposits and Federal Home Loan Bank advances. WaterStone Bank’s deposits consist primarily of certificates of deposit, which accounted for 76.4% of total deposits at June 30, 2013. Our 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 (the “WDFI”) and the Federal Deposit Insurance Corporation.

WaterStone Bank’s mortgage banking operations are conducted through its wholly-owned subsidiary, Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originates residential real estate loans for sale in the secondary market. Waterstone Mortgage Corporation utilizes lines of credit provided by WaterStone Bank as a primary source of funds, and also utilizes lines of credit with other financial institutions as needed. During the six months ended June 30, 2013 and the years ended December 31, 2012 and 2011, Waterstone Mortgage Corporation originated \$978.3 million, \$1.75 billion and \$1.03 billion, respectively, in mortgage loans held for sale.

New Waterstone’s executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226, and its telephone number is (414) 761-1000. Our website address is [www.wsbonline.com](http://www.wsbonline.com). Information on this website is not and should not be considered a part of this proxy statement/prospectus.

## Plan of Conversion and Reorganization

The Boards of Directors of Waterstone Financial, Inc., Lamplighter Financial, MHC, WaterStone Bank and New Waterstone have adopted a plan of conversion pursuant to which WaterStone Bank will reorganize from a mutual holding company structure to a stock holding company structure. Public stockholders of Waterstone Financial, Inc. will receive shares in New Waterstone in exchange for their shares of Waterstone Financial, Inc. common

stock based on an exchange ratio. See “—The Exchange of Existing Shares of Waterstone-Federal Common Stock.” This conversion to a stock holding company structure also includes the offering by New Waterstone of shares of its common stock to eligible depositors of WaterStone Bank and to the public, including Waterstone Financial, Inc. stockholders, in a subscription offering and, if necessary, in a community offering and/or in a separate public offering through a syndicate of broker-dealers, referred to in this proxy statement/prospectus as the syndicated offering. Following the conversion and offering, Lamplighter Financial, MHC and Waterstone Financial, Inc. will no longer exist, and New Waterstone will be the parent company of WaterStone Bank.



The conversion and offering cannot be completed unless the stockholders of Waterstone Financial, Inc. approve the plan of conversion. Waterstone Financial, Inc.'s stockholders will vote on the plan of conversion at Waterstone Financial, Inc.'s special meeting. This document is the proxy statement used by Waterstone Financial, Inc.'s board of directors to solicit proxies for the special meeting. It is also the prospectus of New Waterstone regarding the shares of New Waterstone common stock to be issued to Waterstone Financial, Inc.'s stockholders in the share exchange. This document does not serve as the prospectus relating to the offering by New Waterstone of its shares of common stock in the subscription offering and any community offering or syndicated community offering, which will be made pursuant to a separate prospectus.

#### Our Organizational Structure

Since 2005 we have operated in a two-tiered mutual holding company structure. Waterstone-Federal is our federally chartered, publicly-traded stock holding company and the parent company of WaterStone Bank SSB, which we refer to as "WaterStone Bank" in this proxy statement/prospectus. At June 30, 2013, Waterstone-Federal had consolidated assets of \$1.63 billion, deposits of \$893.0 million and stockholders' equity of \$209.3 million. Waterstone-Federal's parent company is Lamplighter Financial, MHC, a federally chartered mutual holding company. At June 30, 2013, Waterstone-Federal had 31,349,317 shares of common stock outstanding, of which 8,299,134 shares, or 26.5%, were owned by the public and the remaining 23,050,183 shares were held by Lamplighter Financial, MHC.

Pursuant to the terms of the plan of conversion and reorganization, we are now converting from the mutual holding company corporate structure to the stock holding company corporate structure. Upon completion of the conversion, Lamplighter Financial, MHC and Waterstone-Federal will cease to exist, and New Waterstone will become the successor corporation to Waterstone-Federal. The shares of New Waterstone being offered in this offering represent the majority ownership interest in Waterstone-Federal currently held by Lamplighter Financial, MHC. Public stockholders of Waterstone-Federal will receive shares of common stock of New Waterstone in exchange for their shares of Waterstone-Federal at an exchange ratio intended to preserve the same aggregate ownership interest in New Waterstone as they had in Waterstone-Federal. Lamplighter Financial, MHC's shares of Waterstone-Federal will be cancelled.

The following diagram shows our current organizational structure, reflecting ownership percentages as of June 30, 2013:

After the conversion and offering are completed, we will be organized as a fully public holding company, as follows:

## Business Strategy

Our goal is to build stockholder value by operating a well-capitalized and profitable financial institution that delivers a superior banking experience to our customers. Beginning in 2007, due to the adverse economic environment, we experienced significant increases in non-performing assets, which resulted in net losses and increased regulatory oversight. In response, we concentrated our efforts on resolving problem assets, curtailing growth, and preserving a strong capital position. We have made significant progress in our efforts while simultaneously building our mortgage banking business, which resulted in a return to profitability in 2012. Net income for the year ended December 31, 2012 was \$34.9 million (which reflected a reversal of a valuation allowance on our deferred tax assets of \$17.0 million), and for the six months ended June 30, 2013 net income was \$9.6 million.

Our current principal business strategies are summarized below:

Continued reduction of problem assets. Our non-performing assets have decreased to \$83.2 million, or 5.10% of total assets at June 30, 2013, from \$141.9 million, or 7.85% of total assets at December 31, 2010. Our non-performing assets at June 30, 2013 included \$53.3 million of non-performing loans and \$30.0 million of real estate owned. Of the \$53.3 million of non-accrual loans, \$20.9 million, or 39.2%, were troubled debt restructurings that were on non-accrual status either due to being past due 90 days or more or because they had not yet performed under the modified terms for a required period of time. At June 30, 2013, total troubled debt restructurings totaled \$47.1 million, of which \$39.9 million, or 84.7%, were performing in accordance with their restructured terms. Reducing our level of non-performing assets will continue to be a key element of our business strategy.

Controlled loan growth with a focus on multi-family and commercial real estate lending. Our principal business activity historically has been the origination of residential mortgage loans, including multi-family residential real estate loans, for retention in our portfolio. As part of our strategy of increasing our commercial business and commercial real estate loan portfolios, we established a commercial loan department in 2007. We currently have four commercial business loan officers and six commercial real estate loan officers. Multi-family residential and commercial real estate loans comprised 73.5% and 66.9% of total loans originated for investment during the six months ended June 30, 2013 and the year ended December 31, 2012, respectively, while one- to four-family residential mortgage loans comprised 14.4% and 17.2% of total originations during the same periods. We intend to continue our emphasis on multi-family residential and commercial real estate lending. However, we would purchase adjustable-rate one-to

four-family mortgage loans from Waterstone Mortgage Corporation in the future in the event changes in interest rates or consumer preferences enable Waterstone Mortgage Corporation to originate such loans.

Continued emphasis on mortgage banking operations. Waterstone Mortgage Corporation has become a significant originator of fixed-rate, one-to-four family mortgage loans, with total originations of \$978.3 million, \$1.75 billion and \$1.03 billion during the six months ended June 30, 2013 and the years ended December 31, 2012 and 2011, respectively. Subject to market conditions and particularly changes in the interest rate environment, we intend to continue to grow our mortgage banking business, which has been a significant source of our net income in recent periods. Such growth may occur through geographic expansion, online direct consumer origination, or both.

Enhance core earnings by increasing lower cost transaction and savings accounts. Demand, checking and money market accounts are a lower cost source of funds than time deposits, and we have made a concerted effort to increase lower-cost transaction deposit accounts and reduce time deposits. Our ratio of time deposits to total deposits has decreased from 87.1% at December 31, 2008 to 76.4% at June 30, 2013. We intend to continue to aggressively market our core

transaction accounts and savings accounts, emphasizing our high quality service and competitive pricing of these products. In the past two years we have also introduced remote deposit capture, internet banking and mobile banking.

Stockholder-focused management of capital. We recognize that a strong capital position is essential to achieving our long-term objective of building stockholder value. Following the offering, at the minimum of the offering range, our pro forma tier 1 leverage ratio is expected to be 16.80% and our pro forma total risk-based capital ratio is expected to be 26.50%. This capital position will support our future growth and expansion, and will give us flexibility to pursue other capital management strategies to enhance stockholder value. In particular, New Waterstone intends to commence paying regular quarterly dividends following completion of the conversion. See “Our Dividend Policy” for a discussion of our expected dividend policy following the completion of the conversion.

Disciplined expansion through organic growth coupled with opportunistic acquisitions. Since our initial public offering, we have opened three additional branches in the Milwaukee area. In October 2013, we opened a loan production office in Maple Grove, Minnesota, a part of the greater Minneapolis-St. Paul metropolitan area. We have also received regulatory approval to open a new full-service banking office in Brookfield, Wisconsin, which we expect to open in January 2014. Subject to regulatory approval, we plan to open two offices in each of 2014 through 2016 (including our new Brookfield office), all in our local market area, and we may also seek to open additional loan production offices or full service branches in other markets. Waterstone Mortgage Corporation now has locations in 14 states and does business nationally. While organic growth has been our primary focus, we will also consider acquisition opportunities that we believe will enhance our franchise and yield financial benefits for our stockholders.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Business Strategy” for a more complete discussion of our business strategy.

#### Reasons for the Conversion

Our primary reasons for converting to the fully public stock form of ownership and undertaking the stock offering are to:

Eliminate the uncertainties associated with the mutual holding company structure under financial reform legislation. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, the Federal Reserve Board became the federal regulator of all savings and loan holding companies and mutual holding companies, which has resulted in changes in regulations applicable to Lamplighter Financial, MHC and Waterstone-Federal. Among other things, these changes have adversely affected our ability to pay cash dividends to our stockholders, including the ability of Lamplighter Financial, MHC to waive any dividends declared by Waterstone-Federal. The conversion will eliminate our mutual holding company structure and will enable us to pay dividends to our stockholders, subject to the customary legal, regulatory and financial considerations applicable to all financial institutions. See “Our Dividend Policy.” It also will eliminate the risk that the Federal Reserve Board will amend existing regulations applicable to the conversion process in a manner disadvantageous to our public stockholders or depositors.

Transition us to a more familiar and flexible organizational structure. The stock holding company structure is a more familiar form of organization, which we believe will make our common stock more appealing to investors, and will give us greater flexibility to access the capital markets through possible future equity and debt offerings, although we have no current plans, agreements or understandings regarding any additional securities offerings.

Enhance our regulatory capital position. A strong capital position is essential to achieving our long-term objective of building stockholder value. While WaterStone Bank significantly exceeds all regulatory capital requirements, the proceeds from the offering will greatly strengthen our capital position and enable us to support our planned growth and expansion. Minimum regulatory capital requirements will also increase in the future under recently adopted regulations, and compliance with these new requirements will be essential to the continued implementation of our business strategy.

Improve the liquidity of our shares of common stock. The larger number of shares that will be outstanding after completion of the conversion and offering is expected to result in a more liquid and active market for Waterstone-Federal common stock. A more liquid and active market will make it easier for our stockholders to buy and sell our common stock and will give us greater flexibility in implementing capital management strategies.

Facilitate future mergers and acquisitions. Although we do not currently have any understandings or agreements regarding any specific acquisition transaction, the stock holding company structure will give us greater flexibility to structure, and make us a more attractive and competitive bidder for, mergers and acquisitions of other financial institutions as opportunities arise. The additional capital raised in the offering also will enable us to consider larger merger transactions. In addition, although we intend to remain an independent financial institution, the stock holding company structure may make us a more attractive acquisition candidate for other institutions. Applicable regulations prohibit the acquisition of New Waterstone for three years following completion of the conversion.

See “Proposal 1 — Approval of the Plan of Conversion and Reorganization” for a more complete discussion of our reasons for conducting the conversion and offering.

#### Conditions to Completion of the Conversion

We cannot complete the conversion and offering unless:

The plan of conversion and reorganization is approved by at least a majority of votes eligible to be cast by members of Lamplighter Financial, MHC (depositors of WaterStone Bank) as of October 31, 2013;

The plan of conversion and reorganization is approved by Waterstone-Federal stockholders holding at least two-thirds of the outstanding shares of common stock of Waterstone-Federal as of October 31, 2013, including shares held by Lamplighter Financial, MHC;

The plan of conversion and reorganization is approved by Waterstone-Federal stockholders holding at least a majority of the outstanding shares of common stock of Waterstone-Federal as of October 31, 2013, excluding shares held by Lamplighter Financial, MHC;

We sell at least the minimum number of shares of common stock offered in the offering;

The WDFI approves New Waterstone's acquisition of WaterStone Bank and an amendment to WaterStone Bank's Articles of Incorporation to provide for a liquidation account; and

We receive the approval of the Federal Reserve Board to complete the conversion and offering.

Lamplighter Financial, MHC intends to vote its shares in favor of the plan of conversion and reorganization. At October 31, 2013, Lamplighter Financial, MHC owned 73.5% of the outstanding shares of



common stock of Waterstone-Federal. Therefore, the condition requiring that the plan of conversion and reorganization be approved by Waterstone-Federal stockholders holding at least two-thirds of the outstanding shares of common stock of Waterstone-Federal, including shares held by Lamplighter Financial, MHC, would be satisfied. The directors and executive officers of Waterstone-Federal and their affiliates owned 939,892 shares of Waterstone-Federal (excluding exercisable options), or 3.0% of the outstanding shares of common stock and 11.3% of the outstanding shares of common stock excluding shares held by Lamplighter Financial, MHC. They intend to vote those shares in favor of the plan of conversion and reorganization.

#### The Exchange of Existing Shares of Waterstone-Federal Common Stock

If you are currently a stockholder of Waterstone-Federal, at the completion of the conversion your shares will be exchanged for shares of common stock of New Waterstone. The number of shares of common stock you will receive will be based on the exchange ratio, which will depend upon our final appraised value and the percentage of outstanding shares of Waterstone-Federal common stock owned by public stockholders immediately prior to the completion of the conversion. The following table shows how the exchange ratio will adjust, based on the appraised value of New Waterstone as of July 19, 2013, assuming public stockholders of Waterstone-Federal own 26.5% of Waterstone-Federal common stock immediately prior to the completion of the conversion. The table also shows the number of shares of New Waterstone common stock a hypothetical owner of Waterstone-Federal common stock would receive in exchange for 100 shares of Waterstone-Federal common stock owned at the completion of the conversion, depending on the number of shares of common stock issued in the offering.

Shares to be Sold in This Offering		Shares of New Waterstone to be Issued for Shares of Waterstone-Federal		Total Shares of Common Stock to be Issued in Exchange and Offering	Exchange Ratio	Equivalent Value of Shares Based Upon Offering Price (1)	Equivalent Pro Forma Tangible Book Value Per Share Exchanged (2)	Shares to be Received for 100 Existing Shares (3)	
Amount	Percent	Amount	Percent	Offering	Ratio	(1)	(2)	Shares (3)	
Minimum	18,700,000	73.5%	6,731,209	26.5%	25,431,209	0.8111	\$ 8.11	\$ 11.69	81
Midpoint	22,000,000	73.5	7,919,069	26.5	29,919,069	0.9542	9.54	12.59	95
Maximum	25,300,000	73.5	9,106,929	26.5	34,406,929	1.0973	10.97	13.47	109

- (1) Represents the value of shares of New Waterstone common stock to be received in the conversion by a holder of one share of Waterstone-Federal, pursuant to the exchange ratio, based upon the \$10.00 per share purchase price.
- (2) Represents the pro forma tangible book value per share at each level of the offering range multiplied by the respective exchange ratio.
- (3) Cash will be paid in lieu of fractional shares.

No fractional shares of New Waterstone common stock will be issued to any public stockholder of Waterstone-Federal. For each fractional share that otherwise would be issued, New Waterstone will pay in cash an

amount equal to the product obtained by multiplying the fractional share interest to which the holder otherwise would be entitled by the \$10.00 per share offering price.

Outstanding options to purchase shares of Waterstone-Federal common stock also will convert into and become options to purchase shares of New Waterstone common stock based upon the exchange ratio. The aggregate exercise price, duration and vesting schedule of these options will not be affected by the conversion. At June 30, 2013, there were 1,011,500 outstanding options to purchase shares of Waterstone-Federal common stock, 781,500 of which have vested. Such outstanding options will be converted into options to purchase 820,428 shares of common stock at the minimum of the offering range and 1,109,919 shares of common stock at the maximum of the offering range. Because federal regulations prohibit us from repurchasing our common stock during the first year following the conversion unless compelling business reasons exist for such repurchases, we may use authorized but unissued shares to fund option exercises that occur during the first year following the conversion. If all existing options were exercised and funded with authorized but unissued shares of common stock following the conversion, stockholders would experience ownership dilution of approximately 5.0% at the minimum of the offering range.

## How We Determined the Offering Range, the Exchange Ratio and the \$10.00 Per Share Stock Price

The amount of common stock we are offering for sale and the exchange ratio for the exchange of shares of New Waterstone for shares of Waterstone-Federal are based on an independent appraisal of the estimated market value of New Waterstone, assuming the offering has been completed. RP Financial, LC., our independent appraiser, has estimated that, as of July 19, 2013, this market value was \$299.2 million. Based on federal regulations, this market value forms the midpoint of a valuation range with a minimum of \$254.3 million and a maximum of \$344.1 million. Based on this valuation range, the 73.5% ownership interest of Lamplighter Financial, MHC in Waterstone-Federal as of June 30, 2013 being sold in the offering and the \$10.00 per share price, the number of shares of common stock being offered for sale by New Waterstone ranges from 18,700,000 shares to 25,300,000 shares. The \$10.00 per share price was selected primarily because it is the price most commonly used in mutual-to-stock conversions of financial institutions, and it more closely reflects the market price of Waterstone-Federal's common stock than a lower price previously considered by the board of directors. The exchange ratio ranges from 0.8111 shares at the minimum of the offering range to 1.0973 shares at the maximum of the offering range, and will preserve the existing percentage ownership of public stockholders of Waterstone-Federal (excluding any new shares purchased by them in the stock offering and their receipt of cash in lieu of fractional shares).

The appraisal is based in part on Waterstone-Federal's financial condition and results of operations, the pro forma effect of the additional capital raised by the sale of shares of common stock in the offering, and an analysis of a peer group of ten publicly traded thrift holding companies that RP Financial, LC. considers comparable to Waterstone-Federal. The appraisal peer group consists of the following companies, all of which are traded on the Nasdaq Stock Market.

Company Name	Ticker Symbol	Headquarters	Total Assets (1) (In millions)
Bank Mutual Corporation	BKMU	Milwaukee, WI	\$ 2,394
First Defiance Financial Corp.	FDEF	Defiance, OH	\$ 2,039
Meta Financial Group, Inc.	CASH	Sioux Falls, SD	\$ 1,740
Pulaski Financial Corporation	PULB	St. Louis, MO	\$ 1,351
HF Financial Corp.	HFFC	Sioux Falls, SD	\$ 1,197
NASB Financial, Inc.	NASB	Grandview, MO	\$ 1,179
Fox Chase Bancorp, Inc.	FXCB	Hatboro, PA	\$ 1,085
Franklin Financial Corporation	FRNK	Glen Allen, VA	\$ 1,052
First Financial Northwest, Inc.	FFNW	Renton, WA	\$ 887
Simplicity Bancorp, Inc.	SMPL	Covina, CA	\$ 882

(1) Asset size for all companies is as of March 31, 2013.

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The following table presents a summary of selected pricing ratios for New Waterstone (on a pro forma basis) based on earnings and other information as of and for the twelve months ended June 30, 2013 and for the peer group companies based on earnings and other information as of and for the twelve months ended March 31, 2013, and stock prices as of July 19, 2013, as reflected in the appraisal report. Compared to the average pricing of the peer group, our pro forma pricing ratios at the midpoint of the offering range indicated a discount of 28.7% on a price-to-book value basis, a discount of 31.7% on a price-to-tangible book value basis, and a discount of 34.8% on a price-to-earnings basis.

	Price-to-earnings multiple (1)	Price-to-book value ratio	Price-to-tangible book value ratio
New Waterstone (on a pro forma basis, assuming completion of the conversion)			
Maximum	20.19x	81.23%	81.38%
Midpoint	17.40x	75.70%	75.81%
Minimum	14.66x	69.25%	69.38%
Valuation of peer group companies, all of which are fully converted (on an historical basis)			
Averages	26.67x	106.18%	111.04%
Medians	28.78x	106.77%	110.01%

(1) Price-to-earnings multiples calculated by RP Financial, LC. in the independent appraisal are based on an estimate of “core” or recurring earnings on a trailing twelve-month basis through June 30, 2013 for NewWaterstone and March 31, 2013 for the peer group. These ratios are different than those presented in “Pro Forma Data.”

The independent appraisal does not indicate trading market value. Do not assume or expect that our valuation as indicated in the appraisal means that after the conversion and offering the shares of our common stock will trade at or above the \$10.00 per share purchase price. Furthermore, the pricing ratios presented in the appraisal were used by RP Financial, LC. to estimate our pro forma appraised value for regulatory purposes and not to compare the relative value of shares of our common stock with the value of the capital stock of the peer group. The value of the capital stock of a particular company may be affected by a number of factors such as financial performance, asset size and market location.

For a more complete discussion of the amount of common stock we are offering for sale and the independent appraisal, see “Proposal 1 — Approval of the Plan of Conversion and Reorganization—Stock Pricing and Number of Shares to be Issued.”

#### How We Intend to Use the Proceeds From the Offering

We intend to invest at least 50% of the net proceeds from the stock offering in WaterStone Bank, loan funds to our employee stock ownership plan to fund its purchase of shares of common stock in the stock offering and retain the remainder of the net proceeds from the offering at New Waterstone. Therefore, assuming we sell 22,000,000 shares of common stock in the stock offering, and we have net proceeds of \$212.3 million, we intend to invest \$106.1 million in WaterStone Bank, loan \$17.6 million to our employee stock ownership plan to fund its purchase of shares of common stock, and retain the remaining \$88.5 million of the net proceeds at New Waterstone.

New Waterstone may use the funds it retains for investment, to pay cash dividends, to repurchase shares of common stock, to acquire other financial institutions and for other general corporate purposes. WaterStone Bank may use the proceeds it receives to expand its branch network, to support increased lending and other products and services or to acquire other financial institutions.

Please see the section of this proxy statement/prospectus entitled “How We Intend to Use the Proceeds from the Offering” for more information on the proposed use of the proceeds from the offering.

## Our Dividend Policy

After the completion of the conversion, we intend to pay cash dividends on a quarterly basis. Initially, we expect the quarterly dividends to be \$0.05 per share, which equals \$0.20 per share on an annualized basis and an annual yield of 2.0% based on a price of \$10.00 per share.

The dividend rate and the initial and continued payment of dividends will depend on a number of factors, including the receipt of any necessary regulatory approval to pay dividends, our capital requirements, our financial condition and results of operations, tax considerations, statutory and regulatory limitations, and general economic conditions. We cannot assure you that we will receive regulatory approval to pay dividends in the future or when such approval may be obtained, or that any such dividends will not be reduced or eliminated in the future.

For information regarding our current and proposed dividend policy, see “Our Dividend Policy.” For additional information regarding our ability to declare and pay cash dividends, see “Supervision and Regulation—Regulatory Developments.”

#### Purchases and Ownership by Officers and Directors

We expect our directors and executive officers, together with their associates, to subscribe for 198,500 shares of common stock in the offering, representing 1.1% of shares to be sold at the minimum of the offering range. The purchase price paid by them will be the same \$10.00 per share price paid by all other persons who purchase shares of common stock in the offering. Following the conversion, our directors and executive officers, together with their associates, are expected to beneficially own 1,333,702 shares of common stock (including stock options exercisable within 60 days of October 31, 2013), or 5.1% of our total outstanding shares of common stock at the minimum of the offering range, which includes shares they currently own that will be exchanged for shares of New Waterstone.

See “Subscriptions by Directors and Executive Officers” for more information on the proposed purchases of shares of common stock by our directors and executive officers.

#### Benefits to Management and Potential Dilution to Stockholders Resulting from the Conversion

We expect our employee stock ownership plan, which is a tax-qualified retirement plan for the benefit of all WaterStone Bank employees, to purchase up to 8% of the shares of common stock we sell in the offering. If we receive orders in the subscription offering for more shares of common stock than the maximum of the offering range, the employee stock ownership plan’s subscription order will not be filled and the employee stock ownership plan may, with prior Federal Reserve Board approval, purchase shares in the open market following completion of the conversion.

Federal regulations permit us to implement one or more new stock-based benefit plans no earlier than six months after completion of the conversion. Stockholder approval of these plans would be required. Our current intention is to implement one or more new stock-based benefit plans, but we have not determined whether we would adopt the plans within 12 months following the completion of the conversion or more than 12 months following the completion of the conversion. If we implement stock-based benefit plans within 12 months following the completion of the conversion, the stock-based benefit plans would reserve a number of shares (i) up to 4% of the shares of common stock sold in the offering (reduced by amounts purchased by our 401(k) plan using its purchase priority in the stock offering) for awards of restricted stock to key employees and directors, at no cost to the recipients, and (ii) up to 10% of the shares of common stock sold in the offering for issuance pursuant to the exercise of stock options by key employees and directors. If the stock-based benefit plan is adopted more than 12 months after the completion of the conversion, it would not be subject to the percentage limitations set forth above. We have not yet determined the number of shares that would be reserved for issuance under these plans. For a description of our current stock-based benefit plan, see “Management—Compensation Discussion and Analysis—Equity Awards.”

The following table summarizes the number of shares of common stock and the aggregate dollar value of grants that are available under one or more stock-based benefit plans if such plans reserve a number of shares of common stock equal to 4% and 10% of the shares sold in the stock offering for restricted stock awards and stock options, respectively. The table shows the dilution to stockholders if all such shares are issued from authorized but unissued shares, instead of shares purchased in the open market. A portion of the stock grants shown in the table below may

be made to non-management employees. The table also sets forth the number of shares of common stock to be acquired by the employee stock ownership plan for allocation to all qualifying employees.



	Number of Shares to be Granted or Purchased		Dilution Resulting From	Value of Grants (In Thousands) (1)		
	At Minimum of Offering Range	At Maximum of Offering Range			As a Percentage of Common Stock to be Sold in the Offering	Issuance of Shares for Stock-Based Benefit Plans
Employee stock ownership plan	1,496,000	2,024,000	8.0%	N/A(2)	\$ 14,960	\$ 20,240
Restricted stock awards	748,000	1,012,000	4.0	2.86%	7,480	10,120
Stock option	1,870,000	2,530,000	10.0	6.85%	4,862	6,578
Total	4,114,000	5,566,000	22.0%	9.33%	\$ 27,302	\$ 36,938

(1) The actual value of restricted stock awards will be determined based on their fair value as of the date grants are made. For purposes of this table, fair value for stock awards is assumed to be the same as the offering price of \$10.00 per share. The fair value of stock options has been estimated at \$2.60 per option using the Black-Scholes option pricing model with the following assumptions: a grant-date share price and option exercise price of \$10.00; an expected option term of 10 years; a dividend yield of 2.0%; a risk-free rate of return of 2.52%; and expected volatility of 24.17%. The actual value of option grants will be determined by the grant-date fair value of the options, which will depend on a number of factors, including the valuation assumptions used and the option pricing model ultimately adopted.

(2) No dilution is reflected for the employee stock ownership plan because such shares are assumed to be purchased in the stock offering.

We may fund our stock-based benefit plans through open market purchases, as opposed to new issuances of stock; however, if any options previously granted under our existing 2006 Equity Incentive Plan are exercised during the first year following completion of the offering, they will be funded with newly issued shares as federal regulations do not permit us to repurchase our shares during the first year following the completion of the offering except to fund the grants of restricted stock under our existing stock-based benefit plan or under extraordinary circumstances.

The following table presents information as of June 30, 2013 regarding our employee stock ownership plan, our 2006 Equity Incentive Plan and our proposed stock-based benefit plan. The table below assumes that 34,406,929 shares are outstanding after the offering, which includes the sale of 25,300,000 shares in the offering at the maximum of the offering range and the issuance of new shares in exchange for shares of Waterstone-Federal using an exchange ratio of 1.0973. It also assumes that the value of the stock is \$10.00 per share.

Existing and New Stock Benefit Plans	Participants Officers and Employees	Shares at Maximum of Offering Range	Estimated Value of Shares	Percentage of Shares Outstanding After the Conversion
<b>Employee Stock Ownership Plan:</b>				
Shares purchased in 2005 offering (1)		835,610 (2)	\$ 8,356,100	2.43 %
Shares to be purchased in this offering		2,024,000	20,240,000	5.88
Total employee stock ownership plan shares		2,859,610	\$ 28,596,100	8.31 %
<b>Restricted Stock Awards:</b>				
<b>2006 Equity Incentive Plan (1)</b>				
New shares of restricted stock	Directors, Officers and Employees	468,483 (3)	\$ 4,684,830 (4)	1.36 %
Total shares of restricted stock		1,012,000	10,120,000 (4)	2.94
<b>Stock Options:</b>				
<b>2006 Equity Incentive Plan (1)</b>				
New stock options	Directors, Officers and Employees	1,171,210 (5)	\$ 3,045,145	3.40 %
Total stock options		2,530,000	6,578,000 (6)	7.35
Total of stock benefit plans		3,701,210	\$ 9,623,145	10.75 %
		8,041,304	\$ 53,024,075	23.36 %

(1) The number of shares indicated has been adjusted for the 1.0973 exchange ratio at the maximum of the offering range.

(2) As of June 30, 2013, 668,488 of these shares, or 609,212 shares prior to adjustment for the exchange, have been allocated.

(3) As of June 30, 2013, 382,628 of these shares, or 348,700 shares prior to adjustment for the exchange, have been awarded, and 293,747 of these shares, or 267,700 shares prior to adjustment for the exchange, have vested.

(4) The value of restricted stock awards is determined based on their fair value as of the date grants are made. For purposes of this table, the fair value of awards under the new stock-based benefit plan is assumed to be the same as the offering price of \$10.00 per share.

(5) As of June 30, 2013, options to purchase 1,109,919 of these shares, or 1,011,500 shares prior to adjustment for the exchange, have been awarded, and options to purchase 857,540 of these shares, or 781,500 shares prior to adjustment for the exchange, have vested.

(6) The weighted-average fair value of stock options to be granted has been estimated at \$2.60 per option, using the Black-Scholes option pricing model with the following assumptions: exercise price, \$10.00; trading price on date of grant, \$10.00; dividend yield, 2.0%; expected term, 10 years; expected volatility, 24.17%; and risk-free rate of return, 2.52%. The actual value of option grants will be determined by the grant-date fair value of the options, which will depend on a number of factors, including the valuation assumptions used and the option pricing model ultimately adopted.

## Market for Common Stock

Existing publicly held shares of Waterstone-Federal's common stock are listed on the Nasdaq Global Select Market under the symbol "WSBF." Upon completion of the conversion, the shares of common stock of New Waterstone will replace the existing shares, and we expect the shares of New Waterstone common stock will also trade on the Nasdaq Global Select Market under the symbol "WSBF." In order to list our stock on the Nasdaq Global Select Market, we are required to have at least three broker-dealers who will make a market in our common stock. As of October 31, 2013, Waterstone-Federal had approximately 27 registered market makers in its common stock. Sandler O'Neill & Partners, L.P. and Robert W. Baird & Co. Incorporated have advised us that they intend to make a market in our common stock following the offering, but are under no obligation to do so.

## Tax Consequences

Lamplighter Financial, MHC, Waterstone-Federal, WaterStone Bank and New Waterstone have received an opinion of counsel, Luse Gorman Pomerenk & Schick, P.C., regarding the material federal income tax consequences of the conversion, and have received an opinion of Baker Tilly Virchow Krause, LLP regarding the material Wisconsin state tax consequences of the conversion. As a general matter, the conversion will not be a taxable transaction for purposes of federal or state income taxes to Lamplighter Financial, MHC, Waterstone-Federal (except for cash paid for fractional shares), WaterStone Bank, New Waterstone, persons eligible to subscribe in the subscription offering, or existing stockholders of Waterstone-Federal. Existing stockholders of Waterstone-Federal who receive cash in lieu of fractional shares of New Waterstone will recognize a gain or loss equal to the difference between the cash received and the tax basis of the fractional share.

#### Changes in Stockholders' Rights for Existing Stockholders of Waterstone Financial, Inc.

As a result of the conversion, existing stockholders of Waterstone Financial, Inc. will become stockholders of New Waterstone. Some rights of stockholders of New Waterstone will be reduced compared to the rights stockholders currently have in Waterstone Financial, Inc. The reduction in stockholder rights results from differences between the federal and Maryland charters and bylaws, and from distinctions between federal and Maryland law. Many of the differences in stockholder rights under the articles of incorporation and bylaws of New Waterstone are not mandated by Maryland law but have been chosen by management as being in the best interests of New Waterstone and all of its stockholders. The differences in stockholder rights in the articles of incorporation and bylaws of New Waterstone include the following: (i) greater lead time required for shareholders to submit proposals for certain provisions of new business or to nominate directors; (ii) approval by at least 80% of outstanding shares required to amend the bylaws and certain provisions of the articles of incorporation; and (iii) a limit on voting rights of shares beneficially owned in excess of 10% of New Waterstone's outstanding voting stock. See "Comparison of Stockholders' Rights For Existing Stockholders of Waterstone Financial, Inc." for a discussion of these differences.

#### Dissenters' Rights

Stockholders of Waterstone Financial, Inc. do not have dissenters' rights in connection with the conversion and offering.

#### Important Risks in Owning New Waterstone's Common Stock

Before you vote on the conversion, you should read the "Risk Factors" section beginning on page 21 of this proxy statement/prospectus.

## RISK FACTORS

You should consider carefully the following risk factors when deciding how to vote on the conversion and before purchasing shares of New Waterstone common stock.

### Risks Related to Our Business

We operate in a highly regulated environment and we are subject to supervision, examination and enforcement action by various bank 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 system of regulation is designed primarily for the protection of the Deposit Insurance Fund and our depositors, and not for the benefit of our stockholders. Under this system of regulation, the regulatory authorities have extensive discretion in connection with their supervisory, enforcement, rulemaking and examination activities and policies, including rules or policies that: establish minimum capital levels; restrict the timing and amount of dividend payments; govern the classification of assets; determine the adequacy of loan loss reserves for regulatory purposes; and establish the timing and amounts of assessments and fees.

Moreover, as part of their examination authority, the banking regulators assign numerical ratings to banks and savings institutions relating to capital, asset quality, management, liquidity, earnings and other factors. These ratings are inherently subjective and the receipt of a less than satisfactory rating in one or more categories may result in enforcement action by the banking regulators against a financial institution. A less than satisfactory rating may also prevent a financial institution, such as WaterStone Bank or its holding company, from obtaining necessary regulatory approvals to access the capital markets, pay dividends, acquire other financial institutions or establish new branches.

Federal regulations governing the conversion require that we prepare a business plan that addresses, among other items, our projected operations and activities for three years following the conversion. The business plan is a confidential document that is submitted to the banking regulatory agencies and may not reflect currently unanticipated potential business opportunities or activities, such as increased dividends or acquisitions of other financial institutions. Federal regulations require that we operate within the parameters of the business plan, and that the Federal Reserve Board approve any material deviation from the business plan. This could affect our ability to conduct activities that deviate from the regulatory business plan that would otherwise benefit our stockholders.

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.

Waterstone-Federal has adopted board resolutions requested by the Federal Reserve Board. The board resolutions restrict our operations, and the failure to comply with the resolutions could result in additional enforcement actions by the Federal Reserve Board. Continued compliance with the board resolutions may also adversely affect our financial condition and operations.

Effective July 9, 2013, the Federal Reserve Board terminated an Order to Cease and Desist that was originally issued to Waterstone-Federal by the Office of Thrift Supervision on November 25, 2009. At the same time, the Federal Reserve Board requested that the board of directors adopt resolutions relating to certain operations of Waterstone-Federal. The board resolutions require written approval from the Federal Reserve Board prior to the declaration or payment of dividends, any increase in debt or the redemption of holding company stock. Waterstone-Federal's board has adopted the resolutions requested by the Federal Reserve Board and we cannot determine when New Waterstone would no longer be subject to the conditions of the board resolutions.

Failure to comply with the board resolutions could result in additional enforcement actions by the Federal Reserve Board. We have incurred significant expense in complying with the Order to Cease and Desist, and continued compliance with the board resolutions may restrict our operations or result in continued expense, either of which may adversely affect our financial condition and results of operations.

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

Our earnings and cash flows are dependent on our net interest income and income from our mortgage banking operations. 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. Changes 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 volumes 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.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Management of Market Risk.”

Higher interest rates may reduce our mortgage banking revenues, which would negatively impact our net income.

Our mortgage banking operations provide a significant portion of our non-interest income and are significantly affected by market interest rates. Any increase in market interest rates may reduce our mortgage banking income. For example, following the increase in interest rates in the spring of 2013, our mortgage banking revenues decreased to \$20.3 million for the three months ended September 30, 2013 from \$26.0 million for the three months ended June 30, 2013. We generate 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 mortgage loan originations may decrease, resulting in fewer loans that are available for sale. This would result in a decrease in interest income, a decrease in revenues from loan sales 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, data processing 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.

A discontinuation of the Federal Reserve Board’s bond purchasing program may adversely affect our mortgage banking revenues.

The Federal Reserve Board has undertaken an unprecedented bond purchase program, known as “quantitative easing.” This program is designed to keep market interest rates low and encourage growth. A

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discontinuation of the Federal Reserve Board's bond repurchase program would likely cause an increase in market interest rates, which may reduce our loan originations by our mortgage banking subsidiary.

We continue to experience high levels of delinquencies, non-accrual loans and charge-offs, which negatively affects our financial condition and results of operations.

We continue to experience high levels of non-accrual loans and loan delinquencies. Our non-accrual loans totaled \$53.3 million, or 4.81% of total loans, at June 30, 2013, \$74.7 million, or 6.59% of total loans, at December 31, 2012 and \$78.2 million, or 6.43% of total loans, at December 31, 2011. Our loans past due totaled \$60.6 million, or 5.5% of total loans receivable, at June 30, 2013, \$74.4 million, or 6.6% of total loans receivable, at December 31, 2012 and \$93.4 million, or 7.7% of total loans, at December 31, 2011. The continued high level of non-performing and delinquent loans has resulted in high levels of loan charge-offs. During the six months ended June 30, 2013 and the year ended December 31, 2012, net charge-offs totaled \$6.2 million and \$9.7 million, respectively. Our high level of problem assets has also increased our costs associated with monitoring delinquent loans and managing and disposing of foreclosed property. We expect these costs to remain elevated until our delinquencies improve and we dispose of our 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 may also lead to additional actions by regulators that may have a direct material effect on our financial condition and results of operations.

The recent federal government shutdown is expected to result in reduced loan originations and related gains on sale during the fourth quarter of 2013, and any future federal government shutdown could negatively affect our financial condition and results of operations.

Our mortgage banking operations provide a significant portion of our non-interest income. During the recent federal government shutdown, we were not able to close certain loans and recognize non-interest income on the sale of those loans due to our inability to verify information related to borrowers, such as payments of federal income taxes. Also, some of the loans we originate are sold directly to government agencies, and some of these sales were unable to be consummated during the shutdown. Although we expect that we will be able to close a majority of these loans, which would result in a timing difference in our recognition of non-interest income, we will incur higher borrowing costs related to the longer period we maintain an outstanding commitment to fund a loan. In addition, we believe that some of these borrowers have determined or will determine not to proceed with their home purchase and not close on their loans, which would result in a permanent loss of the related non-interest income. The recent federal government shutdown could also result in reduced income for government employees or employees of companies that engage in business with the federal government, which could result in greater loan delinquencies, increases in our nonperforming, criticized and classified assets and a decline in demand for our products and services. Any future federal government shutdown could have the same negative effect.

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

At June 30, 2013, certificates of deposit comprised 76.4% 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 deposits and money market accounts. In addition, if our certificates of deposit do not remain with us, we may be required to access other sources of funds, including loan sales, other types of deposits, including replacement certificates of deposit, securities sold under agreements to repurchase, advances from the Federal Home Loan Bank of Chicago and other borrowings. 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 intend to increase our commercial business lending, and we intend to continue our commercial real estate and multi-family residential real estate lending, which may expose us to increased lending risks and have a negative effect on our results of operations.

In an effort to increase our commercial loan portfolio, we established a commercial loan department in 2007 and we currently have four commercial business loan officers. We also continue to focus on originating commercial real estate and multi-family residential real estate loans. These types of loans generally have a higher risk of loss compared to our one- to four-family residential real estate loans. Commercial business loans may expose us to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. In addition, commercial business and commercial real estate loans may also involve relatively large loan balances to individual borrowers or groups of borrowers. These loans also have greater credit risk than residential real estate loans as repayment is generally dependent upon the successful operation of the borrower's business. Also, the collateral underlying commercial business loans may fluctuate in value. Some of our commercial business loans are collateralized by equipment, inventory, accounts receivable or other business assets, and the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use. Multi-family residential real estate and commercial real estate loans involve increased risk because repayment is dependent on income being generated in amounts sufficient to cover property maintenance and debt service. In addition, if loans that are collateralized by real estate become troubled and the value of the real estate has been significantly impaired, then we may not be able to recover the full contractual amount of principal and interest that we anticipated at the time we originated the loan, which could cause us to increase our provision for loan losses and adversely affect our financial condition and results of operations.

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

Our mortgage banking operations provide a significant portion of our non-interest income. 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 these loans. These conditions may fluctuate or worsen in the future. In light of current conditions, there is greater risk in retaining mortgage loans pending their sale 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 operations.

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, which involves originating residential mortgage loans for sale 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. We have experienced more frequent disputes and repurchase demands from these buyers. 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.

Proposed and final regulations could restrict our ability to originate and sell loans.

The Consumer Financial Protection Bureau has issued a rule designed to clarify for lenders how they can avoid legal liability under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that meet this "qualified mortgage" definition will be presumed to have complied with the new ability-to-repay standard. Under the Consumer Financial Protection Bureau's rule, a "qualified mortgage" loan must not contain certain specified features, including:

excessive upfront points and fees (those exceeding 3% of the total loan amount, less "bona fide discount points" for prime loans);

interest-only payments;

negative-amortization; and

terms longer than 30 years.

Also, to qualify as a "qualified mortgage," a borrower's total monthly debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The Consumer Financial Protection Bureau's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive/and or time consuming to make these loans, which could limit our growth or profitability.

In addition, the Dodd-Frank Act requires the regulatory agencies to issue regulations that require securitizers of loans to retain not less than 5% of the credit risk for any asset that is not a "qualified residential mortgage." The regulatory agencies have issued a proposed rule to implement this requirement. The Dodd-Frank Act provides that the definition of "qualified residential mortgage" can be no broader than the definition of "qualified mortgage" issued by the Consumer Financial Protection Bureau for purposes of its regulations (as described above). Although the final rule with respect to the retention of credit risk has not yet been issued, the final rule could have a significant effect on the secondary market for loans and the types of loans we originate, and restrict our ability to make loans.

A continuation or worsening of economic conditions could adversely affect our financial condition and results of operations.

Although the U.S. economy has emerged from the severe recession that occurred in 2008 and 2009, economic growth has been slow and unemployment levels remain high despite the Federal Reserve Board's unprecedented efforts to maintain low market interest rates and encourage economic growth. Recovery by many businesses has been impaired by lower consumer spending. A discontinuation of the Federal Reserve Board's bond purchasing program could result in higher interest rates and reduced economic activity. Moreover, a return to prolonged deteriorating economic conditions could significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Further declines in real estate values and sales volumes and continued elevated unemployment levels may result in greater loan delinquencies, increases in our nonperforming, criticized and classified assets and a decline in demand for our products and services. These events may cause us to incur losses and may adversely affect our financial condition and results of operations.

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

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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 as 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.

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 and natural disasters. 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 by our borrowers.

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 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.

For additional information, see “Business of WaterStone Bank—Competition.”

Our inability to achieve profitability on new branches may negatively affect our earnings.

Subject to our ability to receive regulatory approval, we currently intend to open six new full-service branch offices by the end of 2016, with two branch offices opening in each of 2014, 2015 and 2016. The profitability of these branches will depend on whether the income that we generate from the additional branches will offset the increased expenses resulting from operating new branches. We expect that it may take time before new branches become profitable. During this period, operating new branches may negatively affect our operating results.

For information on restrictions on our ability to establish new branch offices, see “Supervision and Regulation—General.”

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

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, such as New Waterstone, 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 their insured

depository subsidiaries, and requires the components of Tier 1 capital to 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 WaterStone 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, such as WaterStone Bank, will be examined by their applicable bank regulators.

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 condition and results of operations. 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 financial condition and results of operations. We could also be required to apply a new or revised standard retroactively, which may result in our restating our prior period financial statements.

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 security breaches.

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.

Acquisitions may disrupt our business and dilute stockholder value.

We regularly evaluate merger and acquisition opportunities with other financial institutions and financial services companies. As a result, negotiations may take place and future mergers or acquisitions involving cash, debt, or equity securities may occur at any time. We would seek acquisition partners that offer us either significant market presence or the potential to expand our market footprint and improve profitability through economies of scale or expanded services.

Acquiring other banks, businesses, or branches may have an adverse effect on our financial results and may involve various other risks commonly associated with acquisitions, including, among other things:

difficulty in estimating the value of the target company;

payment of a premium over book and market values that may dilute our tangible book value and earnings per share in the short and long term;

potential exposure to unknown or contingent liabilities of the target company;

exposure to potential asset quality problems of the target company;

potential volatility in reported income associated with goodwill impairment losses;

difficulty and expense of integrating the operations and personnel of the target company;

inability to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits;

potential disruption to our business;

potential diversion of our management's time and attention;

the possible loss of key employees and customers of the target company; and

potential changes in banking or tax laws or regulations that may affect the target company.

#### Risks Related to the Offering and the Exchange

The market value of New Waterstone common stock received in the share exchange may be less than the market value of Waterstone-Federal common stock exchanged.

The number of shares of New Waterstone common stock you receive will be based on an exchange ratio that will be determined as of the date of completion of the conversion and offering. The exchange ratio will be based on the percentage of Waterstone Financial, Inc. common stock held by the public prior to the completion of the conversion and offering, the final independent appraisal of New Waterstone common stock prepared by RP Financial, LC. and the number of shares of common stock sold in the offering. The exchange ratio will ensure that existing public stockholders of Waterstone Financial, Inc. common stock will own the same percentage of New Waterstone common stock after the conversion and offering as they owned of Waterstone Financial, Inc. common stock immediately prior to completion of the conversion and offering (excluding any new shares purchased by them in the offering and their receipt of cash in lieu of fractional exchange shares). The exchange ratio will not depend on the market price of Waterstone Financial, Inc. common stock.

The exchange ratio ranges from 0.8111 shares at the minimum and 1.0973 shares at the maximum of the offering range of New Waterstone common stock per share of Waterstone Financial, Inc. common stock. Shares of New Waterstone common stock issued in the share exchange will have an initial value of \$10.00 per share. Depending on the exchange ratio and the market value of Waterstone Financial, Inc. common stock at the time of the exchange, the initial market value of the New Waterstone common stock that you receive in the share exchange could be less than the market value of the Waterstone Financial, Inc. common stock that you currently own. Based on the most recent closing price of Waterstone Financial, Inc. common stock prior to the date of this proxy statement /prospectus, which was \$10.64, unless at least 24,531,544 shares of New Waterstone common stock are sold in the offering (which is between the midpoint and the maximum of the offering range), the initial value of the New Waterstone common stock you receive in the share exchange would be less than the market value of the Waterstone Financial, Inc. common stock you currently own.

There may be a decrease in stockholders' rights for existing stockholders of Waterstone-Federal.

As a result of the conversion, existing stockholders of Waterstone-Federal will become stockholders of New Waterstone. In addition to the provisions discussed above that may discourage takeover attempts that may be favored by stockholders, some rights of stockholders of New Waterstone will be reduced compared to the rights stockholders currently have in Waterstone-Federal. The reduction in stockholder rights results from differences between the federal and Maryland chartering documents and bylaws, and from differences between federal and Maryland law. Many of the differences in stockholder rights under the articles of incorporation and bylaws of New

Waterstone are not mandated by Maryland law but have been chosen by management as being in the best interests of New Waterstone and its stockholders. The articles of incorporation and bylaws of New Waterstone include the following provisions: (i) greater lead time required for stockholders to submit proposals for new business or to nominate directors; and (ii) approval by at least 80% of the outstanding shares of capital stock entitled to vote generally is required to amend the bylaws and certain provisions of the articles of incorporation. See “Comparison of Stockholders’ Rights For Existing Stockholders of Waterstone Financial, Inc.” for a discussion of these differences.

The future price of the shares of common stock may be less than the \$10.00 purchase price per share in the offering.

If you purchase shares of common stock in the offering, you may not be able to sell them later at or above the \$10.00 purchase price in the offering. In many cases, shares of common stock issued by newly converted savings institutions or mutual holding companies have traded below the initial offering price. The aggregate purchase price of the shares of common stock sold in the offering will be based on an independent appraisal. The independent appraisal is not intended, and should not be construed, as a recommendation of any kind as to the advisability of purchasing shares of common stock. The independent appraisal is based on certain estimates, assumptions and projections, all of which are subject to change from time to time. After the shares begin trading, the trading price of our common stock will be determined by the marketplace, and may be influenced by many factors, including prevailing interest rates, the overall performance of the economy, investor perceptions of New Waterstone and the outlook for the financial services industry in general. Price fluctuations in our common stock may be unrelated to our operating performance.

Our failure to effectively deploy the net proceeds may have an adverse effect on our financial performance.

We intend to invest between \$90.1 million and \$122.2 million of the net proceeds of the offering in WaterStone Bank. We may use the remaining net proceeds to invest in short-term investments, repurchase shares of common stock, pay dividends or for other general corporate purposes. We also expect to use a portion of the net proceeds we retain to fund a loan to our employee stock ownership plan to purchase shares of common stock in the offering. WaterStone Bank may use the net proceeds it receives to fund new loans, expand its retail banking franchise by establishing or acquiring new branches or by acquiring other financial institutions or other financial services companies, or for other general corporate purposes. However, with the exception of the loan to the employee stock ownership plan, we have not allocated specific amounts of the net proceeds for any of these purposes, and we will have significant flexibility in determining the amount of the net proceeds we apply to different uses and when we apply or reinvest such proceeds. Also, certain of these uses, such as opening new branches or acquiring other financial institutions, may require the approval of the WDFI, the Federal Deposit Insurance Corporation or the Federal Reserve Board. We have not established a timetable for reinvesting the net proceeds, and we cannot predict how long we will require to reinvest the net proceeds. Our failure to utilize these funds effectively would reduce our profitability and may adversely affect the value of our common stock.

Our return on equity may be low following the stock offering. This could negatively affect the trading price of our shares of common stock.

Net income divided by average equity, known as “return on equity,” is a ratio many investors use to compare the performance of financial institutions. Our return on equity may be low until we are able to leverage the additional capital we receive from the stock offering. Our return on equity will be negatively affected by added expenses associated with our employee stock ownership plan and the stock-based benefit plan we intend to adopt. Until we can increase our net interest income and non-interest income and leverage the capital raised in the stock offering, we expect our return on equity to be low, which may reduce the market price of our shares of common stock.



Our stock-based benefit plans will increase our expenses and reduce our income.

We intend to adopt one or more new stock-based benefit plans after the conversion, subject to stockholder approval, which will increase our annual compensation and benefit expenses related to the stock options and stock awards granted to participants under the stock-based benefit plan. The actual amount of these new stock-related compensation and benefit expenses will depend on the number of options and stock awards actually granted under the plans, the fair market value of our stock or options on the date of grant, the vesting period, and other factors which we cannot predict at this time. In the event we adopt stock-based benefit plans within 12 months following the conversion, the total shares of common stock reserved for issuance pursuant to awards of restricted stock and grants of options under such plans would be limited to 4% and 10%, respectively, of the total shares of our common stock sold in the stock offering. If we award restricted shares of common stock or grant options in excess of these amounts under stock-based benefit plans adopted more than 12 months after the completion of the conversion, our costs would increase further.

In addition, we will recognize expense for our employee stock ownership plan when shares are committed to be released to participants' accounts, and we will recognize expense for restricted stock awards and stock options over the vesting period of awards made to recipients. The expense in the first year following the offering for shares purchased in the offering and for our new stock-based benefit plans has been estimated to be approximately \$4.4 million (\$3.0 million after tax) at the maximum of the offering range as set forth in the pro forma financial information under "Pro Forma Data," assuming the \$10.00 per share purchase price as fair market value. Actual expenses, however, may be higher or lower, depending on the price of our common stock. For further discussion of our proposed stock-based plans, see "Management—Benefits to be Considered Following Completion of the Conversion."

The implementation of stock-based benefit plans may dilute your ownership interest. Historically, stockholders have approved these stock-based benefit plans.

We intend to adopt one or more new stock-based benefit plans following the stock offering. These plans may be funded either through open market purchases or from the issuance of authorized but unissued shares of common stock. Our ability to repurchase shares of common stock to fund these plans will be subject to many factors, including applicable regulatory restrictions on stock repurchases, the availability of stock in the market, the trading price of the stock, our capital levels, alternative uses for our capital and our financial performance. While our intention would be to fund stock-based benefit plans through open market purchases, stockholders would experience a 9.3% dilution in ownership interest at the maximum of the offering range in the event newly issued shares of our common stock are used to fund stock options and shares of restricted common stock in amounts equal to 10% and 4%, respectively, of the shares sold in the offering. In the event we adopt the plan more than 12 months following the conversion, the plan would not be subject to these limitations and stockholders could experience greater dilution.

Although the implementation of stock-based benefit plans would be subject to stockholder approval, historically, the overwhelming majority of stock-based benefit plans adopted by savings institutions and their holding companies following mutual-to-stock conversions have been approved by stockholders.

We have not determined when we will adopt one or more new stock-based benefit plans. Stock-based benefit plans adopted more than 12 months following the completion of the conversion may exceed regulatory restrictions on the size of stock-based benefit plans adopted within 12 months, which would further increase our costs.

If we adopt stock-based benefit plans more than 12 months following the completion of the conversion, then grants of shares of common stock or stock options under our existing and proposed stock-based benefit plans may exceed 4%



and 10%, respectively, of shares of common stock sold in the stock offering. Stock-based benefit plans that provide for awards in excess of these amounts would increase our costs beyond the amounts estimated in “—Our stock-based benefit plans will increase our expenses and reduce our income.” Stock-based benefit plans that provide for awards in excess of these amounts could also result in dilution to stockholders in excess of that described

in “—The implementation of stock-based benefit plans may dilute your ownership interest. Historically, stockholders have approved these stock-based benefit plans.” Although the implementation of stock-based benefit plans would be subject to stockholder approval, the determination as to when such plans would be implemented will be at the discretion of our board of directors.

Various factors may make takeover attempts more difficult to achieve.

Our board of directors has no current intention to sell control of New Waterstone. Our articles of incorporation and bylaws, federal regulations, Maryland law, shares of restricted stock and stock options that we have granted or may grant to employees and directors and stock ownership by our management and directors, and various other factors may make it more difficult for companies or persons to acquire control of New Waterstone without the consent of our board of directors. You may want a takeover attempt to succeed because, for example, a potential acquiror could offer a premium over the then prevailing price of our common stock. For additional information, see “Restrictions on Acquisition of New Waterstone,” and “—Benefits to be Considered Following Completion of the Conversion.”

We may not receive regulatory approval to pay dividends following the completion of the conversion, or we may not pay dividends on our shares of common stock even if we receive regulatory approval.

Waterstone-Federal has never paid dividends on its common stock. Although New Waterstone intends to pay a quarterly cash dividend to its stockholders, stockholders are not entitled to receive dividends. Furthermore, the payment of dividends to all New Waterstone stockholders currently is subject to regulatory approval. We may not receive such regulatory approval, either promptly following the completion of the conversion or at all, or we may only receive approval to pay a smaller special dividend than we currently intend to pay. See “Our Dividend Policy” and “Supervision and Regulation—Regulatory Developments” for additional information.

You may not revoke your decision to purchase New Waterstone common stock in the subscription or community offerings after you send us your order.

Funds submitted or automatic withdrawals authorized in connection with the purchase of shares of common stock in the subscription and community offerings will be held by us until the completion or termination of the conversion and offering, including any extension of the expiration date and consummation of a syndicated or firm commitment underwritten offering. Because completion of the conversion and offering will be subject to regulatory approvals and an update of the independent appraisal prepared by RP Financial, LC., among other factors, there may be one or more delays in completing the conversion and offering. Orders submitted in the subscription and community offerings are irrevocable, and purchasers will have no access to their funds unless the offering is terminated, or extended beyond January 31, 2014, or the number of shares to be sold in the offering is increased to more than 25,300,000 shares or decreased to fewer than 18,700,000 shares.

The distribution of subscription rights could have adverse income tax consequences.

If the subscription rights granted to certain current or former depositors of WaterStone Bank are deemed to have an ascertainable value, receipt of such rights may be taxable in an amount equal to such value. Whether subscription rights are considered to have ascertainable value is an inherently factual determination. We have received an opinion of counsel, Luse Gorman Pomerenk & Schick, P.C., that it is more likely than not that such rights have no value; however, such opinion is not binding on the Internal Revenue Service.



## INFORMATION ABOUT THE SPECIAL MEETING

### General

This proxy statement/prospectus is being furnished to you in connection with the solicitation by the board of directors of Waterstone Financial, Inc. of proxies to be voted at the special meeting of stockholders to be held at 11200 West Plank Court, Wauwatosa, Wisconsin, on December 27, 2013, at 11:00 a.m., Central Time, and any adjournment or postponement thereof.

The purpose of the special meeting is to consider and vote upon the Plan of Conversion and Reorganization of Lamplighter Financial, MHC (referred to herein as the “plan of conversion”).

In addition, stockholders will vote on a proposal to approve the adjournment of the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the proposal. Stockholders also will vote on informational proposals with respect to the articles of incorporation of New Waterstone.

Voting in favor of or against the plan of conversion includes a vote for or against the conversion of Lamplighter Financial, MHC to a stock holding company as contemplated by the plan of conversion. Voting in favor of the plan of conversion will not obligate you to purchase any shares of common stock in the offering and will not affect the balance, interest rate or federal deposit insurance of any deposits at WaterStone Bank.

### Who Can Vote at the Meeting

You are entitled to vote your Waterstone Financial, Inc. common stock if our records show that you held your shares as of the close of business on October 31, 2013. If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by your broker or nominee. As the beneficial owner, you have the right to direct your broker or nominee how to vote.

As of the close of business on October 31, 2013, there were 31,349,317 shares of Waterstone Financial, Inc. common stock outstanding. Each share of common stock has one vote.

### Attending the Meeting

If you are a stockholder as of the close of business on October 31, 2013, you may attend the meeting. However, if you hold your shares in street name, you will need proof of ownership to be admitted to the meeting. A recent brokerage statement or a letter from a bank or broker are examples of proof of ownership. If you want to vote your shares of Waterstone Financial, Inc. common stock held in street name in person at the meeting, you will have to get a written proxy in your name from the broker, bank or other nominee who holds your shares.

### Quorum; Vote Required

The special meeting will be held only if there is a quorum. A quorum exists if a majority of the outstanding shares of common stock entitled to vote, represented in person or by proxy, is present at the meeting. If you return valid proxy instructions or attend the meeting in person, your shares will be counted for purposes of determining whether there is

a quorum, even if you abstain from voting. Broker non-votes also will be counted for purposes of determining the existence of a quorum. A broker non-vote occurs when a broker, bank or other nominee holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that item and has not received voting instructions from the beneficial owner.

Proposal 1: Approval of the Plan of Conversion and Reorganization. We must obtain the affirmative vote of the holders of (i) two-thirds of the outstanding common stock of Waterstone Financial, Inc. entitled to be cast at the special meeting, including shares held by Lamplighter Financial, MHC, and (ii) a majority of the

outstanding shares of common stock of Waterstone Financial, Inc. entitled to be cast at the special meeting, other than shares held by Lamplighter Financial, MHC.

Proposal 2: Approval of the adjournment of the special meeting. We must obtain the affirmative vote of at least a majority of the votes cast by Waterstone Financial, Inc. stockholders entitled to vote at the special meeting to adjourn the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the proposal to approve the plan of conversion.

Informational Proposals 3 through 5: Approval of certain provisions in New Waterstone's articles of incorporation. The provisions of New Waterstone's articles of incorporation that are summarized as informational proposals were approved as part of the process in which the board of directors of Waterstone Financial, Inc. approved the plan of conversion. These proposals are informational in nature only, because the Board of Governors of the Federal Reserve System's regulations governing mutual-to-stock conversions do not provide for votes on matters other than the plan of conversion. While we are asking you to vote with respect to each of the informational proposals, the proposed provisions for which an informational vote is requested will become effective if stockholders approve the plan of conversion, regardless of whether stockholders vote to approve any or all of the informational proposals. The provisions of New Waterstone's articles of incorporation that are summarized as informational proposals may have the effect of deterring or rendering more difficult attempts by third parties to obtain control of New Waterstone, if such attempts are not approved by the board of directors, or may make the removal of the board of directors or management, or the appointment of new directors, more difficult.

Other Matters. We must obtain the affirmative vote of the majority of the votes cast by holders of outstanding shares of common stock of Waterstone Financial, Inc. At this time, we know of no other matters that may be presented at the special meeting.

#### Shares Held by Lamplighter Financial, MHC and Our Officers and Directors

As of October 31, 2013, Lamplighter Financial, MHC beneficially owned 23,050,183 shares of Waterstone Financial, Inc. common stock. This equals approximately 73.5% of our outstanding shares. We expect that Lamplighter Financial, MHC will vote all of its shares in favor of Proposal 1—Approval of the Plan of Conversion and Reorganization, Proposal 2—Approval of the adjournment of the special meeting, and Informational Proposals 3 through 5.

As of October 31, 2013, our officers and directors beneficially owned 1,551,892 shares of Waterstone Financial, Inc. common stock. This equals 4.9% of our outstanding shares and 18.7% of shares held by persons other than Lamplighter Financial, MHC.

#### Voting by Proxy

Our board of directors is sending you this proxy statement/prospectus to request that you allow your shares of Waterstone Financial, Inc. common stock to be represented at the special meeting by the persons named in the enclosed proxy card. All shares of Waterstone Financial, Inc. common stock represented at the meeting by properly executed and dated proxies will be voted according to the instructions indicated on the proxy card. If you sign, date and return a proxy card without giving voting instructions, your shares will be voted as recommended by our board of directors. Our board of directors recommends that you vote "FOR" approval of the plan of conversion, "FOR" approval of the adjournment of the special meeting, if necessary, and "FOR" each of the Informational Proposals 3 through 5.

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If any matters not described in this proxy statement/prospectus are properly presented at the special meeting, the board of directors will use their judgment to determine how to vote your shares. We do not know of any other matters to be presented at the special meeting.

If your Waterstone Financial, Inc. common stock is held in street name, you will receive instructions from your broker, bank or other

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nominee that you must follow to have your shares voted. Your broker, bank or other nominee may allow you to deliver your voting instructions via the telephone or the Internet. Please see the instruction form provided by your broker, bank or other nominee that accompanies this proxy statement/prospectus.

#### Revocability of Proxies

You may revoke your proxy at any time before the vote is taken at the special meeting. To revoke your proxy, you must advise the corporate secretary of Waterstone Financial, Inc. in writing before your common stock has been voted at the special meeting, deliver a later-dated proxy or attend the special meeting and vote your shares in person. Attendance at the special meeting will not in itself constitute revocation of your proxy.

#### Solicitation of Proxies

This proxy statement/prospectus and the accompanying proxy card are being furnished to you in connection with the solicitation of proxies for the special meeting by the board of directors. Waterstone Financial, Inc. will pay the costs of soliciting proxies from its stockholders. To the extent necessary to permit approval of the plan of conversion and the other proposals being considered, AST Phoenix Advisors, our proxy solicitor, and directors, officers or employees of Waterstone Financial, Inc. and WaterStone Bank may solicit proxies by mail, telephone and other forms of communication. We will reimburse such persons for their reasonable out-of-pocket expenses incurred in connection with such solicitation. For its services as information agent and stockholder proxy solicitor, we will pay AST Phoenix Advisors \$6,000 plus out-of-pocket expenses and charges for telephone calls made and received in connection with the solicitation.

We will also reimburse banks, brokers, nominees and other fiduciaries for the expenses they incur in forwarding the proxy materials to you.

#### Participants in the Employee Stock Ownership Plan

If you participate in WaterStone Bank Employee Stock Ownership Plan, you will receive a voting instruction form that reflects all shares you may direct the trustees to vote on your behalf under the plan. Under the terms of the Employee Stock Ownership Plan, the Employee Stock Ownership Plan trustee votes all shares held by the Employee Stock Ownership Plan, but each Employee Stock Ownership Plan participant may direct the trustee how to vote the shares of common stock allocated to his or her account. The Employee Stock Ownership Plan trustee, subject to the exercise of its fiduciary duties, will vote all unallocated shares of Waterstone Financial, Inc. common stock held by the Employee Stock Ownership Plan and allocated shares for which no voting instructions are received in the same proportion as shares for which it has received timely voting instructions. The deadline for returning your voting instructions to the plan's trustee is December 23, 2013.

The board of directors recommends that you promptly sign and mark the enclosed proxy in favor of the above described proposals, including the adoption of the plan of conversion, and promptly return it in the enclosed envelope. Voting the proxy card will not prevent you from voting in person at the special meeting. For information on submitting your proxy, please refer to the instructions on the enclosed proxy card.

Your prompt vote is very important. Failure to vote will have the same effect as voting against the plan of conversion.



## PROPOSAL 1 — APPROVAL OF THE PLAN OF CONVERSION AND REORGANIZATION

The boards of directors of Waterstone Financial, Inc. and Lamplighter Financial, MHC have approved the Plan of Conversion and Reorganization of Lamplighter Financial, MHC, referred to herein as the “plan of conversion.” The plan of conversion must also be approved by the members of Lamplighter Financial, MHC (depositors of WaterStone Bank) and the stockholders of Waterstone Financial, Inc. A special meeting of members and a special meeting of stockholders have been called for this purpose. The Board of Governors of the Federal Reserve System has approved the application that includes the plan of conversion; however, such approval does not constitute a recommendation or endorsement of the plan of conversion by the Board of Governors of the Federal Reserve System.

### General

Pursuant to the plan of conversion, our organization will convert from the mutual holding company form of organization to the fully stock form. Currently, WaterStone Bank is a wholly-owned subsidiary of Waterstone Financial, Inc. and Lamplighter Financial, MHC owns approximately 73.5% of Waterstone Financial, Inc.’s common stock. The remaining 26.5% of Waterstone Financial, Inc.’s common stock is owned by public stockholders. As a result of the conversion, a newly formed company, New Waterstone, will become the holding company of WaterStone Bank. Each share of Waterstone Financial, Inc. common stock owned by the public will be exchanged for between 0.8111 shares at the minimum and 1.0973 shares at the maximum of the offering range of New Waterstone common stock, so that Waterstone Financial, Inc.’s existing public stockholders will own the same percentage of New Waterstone common stock as they owned of Waterstone Financial, Inc.’s common stock immediately prior to the conversion (excluding any new shares purchased by them in the offering and their receipt of cash in lieu of fractional exchange shares). The actual number of shares that you will receive will depend on the percentage of Waterstone Financial, Inc. common stock held by the public immediately prior to the completion of the conversion, the final independent appraisal of New Waterstone and the number of shares of New Waterstone common stock sold in the offering described in the following paragraph. It will not depend on the market price of Waterstone Financial, Inc. common stock.

Concurrently with the exchange offer, New Waterstone is offering up to 25,300,000 shares of common stock for sale, representing the 73.5% ownership interest of Lamplighter Financial, MHC in Waterstone Financial, Inc., to eligible depositors and to the public at a price of \$10.00 per share. After the conversion and offering are completed, WaterStone Bank will be a wholly-owned subsidiary of New Waterstone, and 100% of the common stock of New Waterstone will be owned by public stockholders. As a result of the conversion and offering, Waterstone Financial, Inc. and Lamplighter Financial, MHC will cease to exist.

New Waterstone intends to contribute between \$90.1 million and \$122.2 million of the net proceeds to WaterStone Bank and to retain between \$75.1 million and \$101.9 million of the net proceeds. The conversion will be consummated only upon the issuance of at least the minimum number of shares of our common stock offered pursuant to the plan of conversion.

The plan of conversion provides that we will offer shares of common stock in a “subscription offering” in the following descending order of priority:

- (i) To depositors with accounts at WaterStone Bank with aggregate balances of at least \$50 at the close of business on December 31, 2011.
- (ii)

To our tax-qualified employee benefit plans (including WaterStone Bank's employee stock ownership plan and 401(k) plan), which will receive, without payment therefor, nontransferable subscription rights to purchase in the aggregate up to 10% of the shares of common stock sold in the offering. We expect our employee stock ownership plan to purchase 8% of the shares of common stock sold in the stock offering, although we reserve the right to have the employee stock ownership plan purchase more than 8% of the shares sold in the offering to the extent necessary to complete the offering at the minimum of the offering range.

(iii) To depositors with accounts at WaterStone Bank with aggregate balances of at least \$50 at the close of business on September 30, 2013.

(iv) To depositors of WaterStone Bank at the close of business on October 31, 2013.

Shares of common stock not purchased in the subscription offering will be offered for sale to the general public in a community offering, with a preference given first to natural persons (including trusts of natural persons) residing in Milwaukee, Washington and Waukesha Counties, Wisconsin. To the extent shares of common stock remain available, we will also offer the shares to Waterstone-Federal's public stockholders as of October 31, 2013. The community offering is expected to begin concurrently with the subscription offering. We also may offer for sale shares of common stock not purchased in the subscription offering or the community offering through a syndicated or firm commitment underwritten offering. Sandler O'Neill & Partners, L.P. will act as sole book-running manager for the syndicated or firm commitment underwritten offering. We have the right to accept or reject, in our sole discretion, orders received in the community offering or syndicated or firm commitment underwritten offering. Any determination to accept or reject stock orders in the community offering or syndicated or firm commitment underwritten offering will be based on the facts and circumstances available to management at the time of the determination.

We determined the number of shares of common stock to be offered in the offering based upon an independent valuation of the estimated pro forma market value of New Waterstone. All shares of common stock to be sold in the offering will be sold at \$10.00 per share. Investors will not be charged a commission to purchase shares of common stock in the offering. The independent valuation will be updated and the final number of shares of common stock to be issued in the offering will be determined at the completion of the offering. See "—Stock Pricing and Number of Shares to be Issued" for more information as to the determination of the estimated pro forma market value of the common stock.

A copy of the plan of conversion is available for inspection at each branch office of WaterStone Bank and at the Federal Reserve Bank of Chicago. The plan of conversion is also filed as an exhibit to Lamplighter Financial, MHC's application to convert from mutual to stock form of which this proxy statement/prospectus is a part, copies of which may be obtained from the Board of Governors of the Federal Reserve System. The plan of conversion is also filed as an exhibit to the registration statement we have filed with the Securities and Exchange Commission, of which this proxy statement/prospectus is a part, copies of which may be obtained from the Securities and Exchange Commission or online at the Securities and Exchange Commission's website. See "Where You Can Find Additional Information."

The board of directors recommends that you vote "FOR" the Plan of Conversion and Reorganization of Lamplighter Financial, MHC.

#### Reasons for the Conversion

Our primary reasons for converting and undertaking the stock offering are to:

Eliminate the uncertainties associated with the mutual holding company structure under financial reform legislation. Under the Dodd-Frank Act, the Federal Reserve Board became the federal regulator of all savings and loan holding companies and mutual holding companies, which has resulted in changes in regulations applicable to Lamplighter Financial, MHC and Waterstone-Federal. Among other things, these changes have adversely affected our ability to pay cash dividends to our stockholders, including the ability of Lamplighter Financial, MHC to waive any dividends declared by Waterstone-Federal. The conversion will eliminate our mutual holding company

structure and will enable us to pay dividends to our stockholders, subject to the customary legal, regulatory and financial considerations applicable to all financial institutions. See “Our Dividend Policy.” It also will eliminate the risk that the Federal Reserve Board will amend existing regulations applicable to the conversion process in a manner disadvantageous to our public stockholders or depositors.

Transition us to a more familiar and flexible organizational structure. The stock holding company structure is a more familiar form of organization, which we believe will make our common stock more appealing to investors, and will give us greater flexibility to access the capital markets through possible future equity and debt offerings, although we have no current plans, agreements or understandings regarding any additional securities offerings.

Enhance our regulatory capital position. A strong capital position is essential to achieving our long-term objective of building stockholder value. While WaterStone Bank significantly exceeds all regulatory capital requirements, the proceeds from the offering will greatly strengthen our capital position and enable us to support our planned growth and expansion. Minimum regulatory capital requirements will also increase in the future under recently adopted regulations, and compliance with these new requirements will be essential to continued implementation of our business strategy.

Improve the liquidity of our shares of common stock. The larger number of shares that will be outstanding after completion of the conversion and offering is expected to result in a more liquid and active market than currently exists for Waterstone-Federal common stock. A more liquid and active market would make it easier for our stockholders to buy and sell our common stock and would give us greater flexibility in implementing capital management strategies.

Facilitate future mergers and acquisitions. Although we do not currently have any understandings or agreements regarding any specific acquisition transaction, the stock holding company structure will give us greater flexibility to structure and make us a more attractive and competitive bidder for, mergers and acquisitions of other financial institutions as opportunities arise. The additional capital raised in the offering will also enable us to consider larger transactions. In addition, although we intend to remain an independent financial institution, the stock holding company structure may make us a more attractive acquisition candidate for other institutions, although applicable regulations prohibit the acquisition of New Waterstone for three years following completion of the conversion.

#### Approvals Required

The affirmative vote of a majority of the total votes eligible to be cast by the members of Lamplighter Financial, MHC is required to approve the plan of conversion and reorganization. By their approval of the plan of conversion and reorganization, the members of Lamplighter Financial, MHC will also be approving the merger of Lamplighter Financial, MHC into Waterstone-Federal. The affirmative vote of the holders of at least two-thirds of the outstanding shares of common stock of Waterstone-Federal and the affirmative vote of the holders of a majority of the outstanding shares of common stock of Waterstone-Federal held by the public stockholders of Waterstone-Federal (stockholders other than Lamplighter Financial, MHC) also are required to approve the plan of conversion and reorganization. The plan of conversion and reorganization also must be approved by the Federal Reserve Board, which has approved the application that includes the plan of conversion and reorganization. The WDFI must also approve New Waterstone's acquisition of WaterStone Bank and the amendment to WaterStone Bank's articles of incorporation.

#### Share Exchange Ratio for Current Stockholders

Federal regulations provide that in a conversion of a mutual holding company to stock form, the public stockholders will be entitled to exchange their shares for common stock of the new holding company, provided that the mutual holding company demonstrates to the satisfaction of the Federal Reserve Board that the basis for the exchange is fair and reasonable. At the completion of the conversion, each publicly held share of Waterstone-Federal common stock will be converted automatically into the right to receive a number of shares of New Waterstone common stock. The number of shares of common stock will be determined pursuant to the exchange ratio, which ensures that the public

stockholders will own the same percentage of common stock in New Waterstone

after the conversion as they held in Waterstone-Federal immediately prior to the conversion, exclusive of their purchase of additional shares of common stock in the offering and their receipt of cash in lieu of fractional exchange shares. The exchange ratio will not depend on the market value of Waterstone-Federal common stock. The exchange ratio will be based on the percentage of Waterstone-Federal common stock held by the public, the independent valuation of New Waterstone prepared by RP Financial, LC., and the number of shares of common stock issued in the offering. The exchange ratio is expected to range from approximately 0.8111 shares for each publicly held share of Waterstone-Federal at the minimum of the offering range to 1.0973 shares for each publicly held share of Waterstone-Federal at the maximum of the offering range.

The following table shows how the exchange ratio will adjust, based on the appraised value of New Waterstone as of July 19, 2013, assuming public stockholders of Waterstone-Federal own 26.5% of Waterstone-Federal common stock immediately prior to the completion of the conversion. The table also shows how many shares of New Waterstone a hypothetical owner of Waterstone-Federal common stock would receive in the exchange for 100 shares of common stock owned at the completion of the conversion, depending on the number of shares issued in the offering.

	Shares to be Sold in This Offering		Shares of New Waterstone to be Issued for Shares of Waterstone-Federal		Total Shares of Common Stock to be Issued in	Exchange and Offering	Exchange Ratio	Equivalent Pro		
								Equivalent Value of Shares Based Upon	Forma Book Value Per	Shares to be Received for 100 Existing
	Amount	Percent	Amount	Percent			Offering Price (1)	Share (2)	Shares (3)	
Minimum	18,700,000	73.5 %	6,731,209	26.5 %	25,431,209	0.8111	\$ 8.11	\$ 11.69	81	
Midpoint	22,000,000	73.5	7,919,069	26.5	29,919,069	0.9542	9.54	12.59	95	
Maximum	25,300,000	73.5	9,106,929	26.5	34,406,929	1.0973	10.97	13.47	109	

(1) Represents the value of shares of New Waterstone common stock to be received in the conversion by a holder of one share of Waterstone-Federal, pursuant to the exchange ratio, based upon the \$10.00 per share offering price.

(2) Represents the pro forma tangible book value per share at each level of the offering range multiplied by the respective exchange ratio.

(3) Cash will be paid in lieu of fractional shares.

Options to purchase shares of Waterstone-Federal common stock that are outstanding immediately prior to the completion of the conversion will be converted into options to purchase shares of New Waterstone common stock, with the number of shares subject to the option and the exercise price per share to be adjusted based upon the exchange ratio. The aggregate exercise price, term and vesting period of the options will remain unchanged.

#### Effects of Conversion on Depositors, Borrowers and Members

Continuity. The conversion will not affect the normal business of WaterStone Bank of accepting deposits and making loans. WaterStone Bank will continue to be a Wisconsin-chartered savings bank and will continue to be regulated by

the WDFI and the Federal Deposit Insurance Corporation. After the conversion, WaterStone Bank will continue to offer existing services to depositors, borrowers and other customers. The directors serving Waterstone-Federal at the time of the conversion will be the directors of New Waterstone after the conversion.

**Effect on Deposit Accounts.** Pursuant to the plan of conversion and reorganization, each depositor of WaterStone Bank at the time of the conversion will automatically continue as a depositor after the conversion, and the deposit balance, interest rate and other terms of such deposit accounts will not change as a result of the conversion. Each such account will be insured by the Federal Deposit Insurance Corporation to the same extent as before the conversion. Depositors will continue to hold their existing certificates, passbooks and other evidences of their accounts.

**Effect on Loans.** No loan outstanding from WaterStone Bank will be affected by the conversion, and the amount, interest rate, maturity and security for each loan will remain as it was contractually fixed prior to the conversion.



**Effect on Voting Rights of Members.** At present, all depositors of WaterStone Bank are members of, and have voting rights in, Lamplighter Financial, MHC as to all matters requiring membership action. Upon completion of the conversion, depositors will cease to be members of Lamplighter Financial, MHC and will no longer have voting rights. Upon completion of the conversion, all voting rights in WaterStone Bank will be vested in New Waterstone as the sole stockholder of WaterStone Bank. The stockholders of New Waterstone will possess exclusive voting rights with respect to New Waterstone common stock.

**Tax Effects.** We have received an opinion of counsel with regard to the federal income tax consequences of the conversion and an opinion of our tax advisor with regard to the state income tax consequences of the conversion to the effect that the conversion will not be a taxable transaction for federal or state income tax purposes to Lamplighter Financial, MHC, Waterstone-Federal, the public stockholders of Waterstone-Federal (except for cash paid for fractional shares), members of Lamplighter Financial, MHC, eligible account holders, supplemental eligible account holders, or WaterStone Bank. See “—Material Income Tax Consequences.”

**Effect on Liquidation Rights.** Each depositor in WaterStone Bank has both a deposit account in WaterStone Bank and a pro rata ownership interest in the net worth of Lamplighter Financial, MHC based upon the deposit balance in his or her account. This ownership interest is tied to the depositor’s account and has no tangible market value separate from the deposit account. This ownership interest may only be realized in the event of a complete liquidation of Lamplighter Financial, MHC and WaterStone Bank; however, there has never been a liquidation of a solvent mutual holding company. Any depositor who opens a deposit account obtains a pro rata ownership interest in Lamplighter Financial, MHC without any additional payment beyond the amount of the deposit. A depositor who reduces or closes his or her account receives a portion or all of the balance in the deposit account but nothing for his or her ownership interest in the net worth of Lamplighter Financial, MHC, which is lost to the extent that the balance in the account is reduced or closed.

Consequently, depositors in a stock subsidiary of a mutual holding company normally have no way of realizing the value of their ownership interest, which would be realizable only in the unlikely event that Lamplighter Financial, MHC and WaterStone Bank are liquidated. If this occurs, the depositors of record at that time, as owners, would share pro rata in any residual surplus and reserves of Lamplighter Financial, MHC after other claims, including claims of depositors to the amounts of their deposits, are paid.

Under the plan of conversion, Eligible Account Holders and Supplemental Eligible Account Holders will receive an interest in liquidation accounts maintained by New Waterstone and WaterStone Bank in an aggregate amount equal to (i) Lamplighter Financial, MHC’s ownership interest in Waterstone-Federal’s total stockholders’ equity as of the date of the latest statement of financial condition used in New Waterstone’s prospectus for the stock offering plus (ii) the value of the net assets of Lamplighter Financial, MHC as of the date of the latest statement of financial condition of Lamplighter Financial, MHC prior to the consummation of the conversion (excluding its ownership of Waterstone-Federal). New Waterstone and WaterStone Bank will hold the liquidation accounts for the benefit of Eligible Account Holders and Supplemental Eligible Account Holders who continue to maintain deposits in WaterStone Bank after the conversion. The liquidation accounts would be distributed to Eligible Account Holders and Supplemental Eligible Account Holders who maintain their deposit accounts in WaterStone Bank only in the event of a liquidation of (a) New Waterstone and WaterStone Bank or (b) WaterStone Bank. The liquidation account in WaterStone Bank would be used only in the event that New Waterstone does not have sufficient assets to fund its obligations under its liquidation account. The total obligation of New Waterstone and WaterStone Bank under their respective liquidation accounts will never exceed the dollar amount of New Waterstone’s liquidation account as adjusted from time to time pursuant to the plan of conversion and federal regulations. See “—Liquidation Rights.”

Stock Pricing and Number of Shares to be Issued

The plan of conversion and reorganization and federal regulations require that the aggregate purchase price of the common stock sold in the offering must be based on the appraised pro forma market value of the common stock, as determined by an independent valuation. We have retained RP Financial, LC. to prepare an independent valuation appraisal. For its services in preparing the initial valuation, RP Financial, LC. will receive a fee of

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\$90,000, as well as payment for reimbursable expenses, an additional \$15,000 for each updated valuation prepared if more than one update is required, and an additional \$15,000 upon completion of the conversion. We have paid RP Financial, LC. no other fees during the previous three years. We have agreed to indemnify RP Financial, LC. and its employees and affiliates against specified losses, including any losses in connection with claims under the federal securities laws, arising out of its services as independent appraiser, except where such liability results from RP Financial, LC.'s bad faith or negligence.

The independent valuation was prepared by RP Financial, LC. in reliance upon the information contained in this proxy statement/prospectus, including the consolidated financial statements of Waterstone-Federal. RP Financial, LC. also considered the following factors, among others:

the present results and financial condition of Waterstone-Federal and the projected results and financial condition of New Waterstone;

the economic and demographic conditions in Waterstone-Federal's existing market area;

certain historical, financial and other information relating to Waterstone-Federal;

a comparative evaluation of the operating and financial characteristics of Waterstone-Federal with those of other publicly traded savings institutions;

the effect of the conversion and offering on New Waterstone's stockholders' equity and earnings potential;

the proposed dividend policy of New Waterstone; and

the trading market for securities of comparable institutions and general conditions in the market for such securities.

The independent valuation is also based on an analysis of a peer group of publicly traded savings and loan holding companies that RP Financial, LC. considered comparable to New Waterstone under regulatory guidelines applicable to the independent valuation. Under these guidelines, a minimum of ten peer group companies are selected from the universe of all publicly-traded savings institutions with relatively comparable resources, strategies and financial and other operating characteristics. Such companies must also be traded on an exchange (such as Nasdaq or the New York Stock Exchange). The peer group companies selected for New Waterstone also consisted of fully-converted stock institutions that were not subject to an actual or rumored acquisition and that had been in fully-converted form for at least one year. In addition, RP Financial, LC. limited the peer group companies to the following two selection criteria: (1) those institutions headquartered in the Midwest region of the U.S. with total assets between \$1.0 billion and \$5.0 billion and reporting positive net income on a trailing twelve-month basis; and, (2) those institutions located nationwide (other than the Midwest) with total assets between \$750.0 million and \$5.0 billion, reporting positive net income on a trailing twelve-month basis, a tangible equity/assets ratio greater than 15.0% and a non-performing assets/total assets ratio greater than 2.5%.

The independent valuation appraisal considered the pro forma effect of the offering. Consistent with federal appraisal guidelines, the appraisal applied three primary methodologies: (i) the pro forma price-to-book value approach applied to both reported book value and tangible book value; (ii) the pro forma price-to-earnings approach applied to reported and core earnings; and (iii) the pro forma price-to-assets approach. The market value ratios applied in the three methodologies were based on the current market valuations of the peer group companies. RP Financial, LC. placed the

greatest emphasis on the price-to-earnings and price-to-book approaches in estimating pro forma market value. RP Financial, LC. did not consider a pro forma price-to-assets approach to be meaningful in preparing the appraisal, as this approach is more meaningful when a company has low equity or earnings. The price-to-assets approach is less meaningful for a company like us, as we have equity in excess of regulatory capital requirements and positive reported and core earnings.

In applying each of the valuation methods, RP Financial, LC. considered adjustments to the pro forma market value based on a comparison of New Waterstone with the peer group. RP Financial, LC. made downward adjustments for financial condition, earnings, market area and stock market conditions. No adjustments were made for asset growth, dividend policy, liquidity of the stock, management or the effect of government regulations and regulatory reform. The downward valuation adjustments considered, among other things, New Waterstone's less favorable balance sheet structure, including a greater dependence on higher cost borrowed funds and higher non-performing asset ratios than the peer group, a material dependence on mortgage banking operations for net income compared to the peer group, and the general condition of the primary market area in which New Waterstone operates. The valuation adjustment for stock market conditions took into consideration the prevailing stock market environment for the common stock of thrifts and their holding companies, which has been relatively volatile in relation to the U.S. stock market generally, and the results and pro forma pricing ratios of recently completed thrift conversion transactions.

Included in RP Financial, LC.'s independent valuation were certain assumptions as to the pro forma earnings of New Waterstone after the conversion that were used in determining the appraised value. These assumptions included estimated expenses, an assumed after-tax rate of return of 0.85% as of June 30, 2013 on the net offering proceeds and purchases in the open market of 4% of the common stock issued in the offering by the stock-based benefit plan at the \$10.00 per share purchase price. See "Pro Forma Data" for additional information concerning assumptions included in the independent valuation and used in preparing pro forma data. The use of different assumptions may yield different results.

The independent valuation states that as of July 19, 2013, the estimated pro forma market value of New Waterstone was \$299.2 million. Based on federal regulations, this market value forms the midpoint of a range with a minimum of \$254.3 million and a maximum of \$344.1 million. The aggregate offering price of the shares will be equal to the valuation range multiplied by the percentage of Waterstone-Federal common stock owned by Lamplighter Financial, MHC. The number of shares offered will be equal to the aggregate offering price of the shares divided by the price per share. Based on the valuation range, the percentage of Waterstone-Federal common stock owned by Lamplighter Financial, MHC and the \$10.00 price per share, the minimum of the offering range is 18,700,000 shares, the midpoint of the offering range is 22,000,000 shares and the maximum of the offering range is 25,300,000 shares.

The board of directors of New Waterstone reviewed the independent valuation and, in particular, considered the following:

Waterstone-Federal's financial condition and results of operations;

a comparison of financial performance ratios of Waterstone-Federal to those of other financial institutions of similar size;

market conditions generally and in particular for financial institutions; and

the historical trading price of the publicly held shares of Waterstone-Federal common stock.

All of these factors are set forth in the independent valuation. The board of directors also reviewed the methodology and the assumptions used by RP Financial, LC. in preparing the independent valuation and believes that such assumptions were reasonable. The offering range may be amended with the approval of the Federal Reserve Board, if required, as a result of subsequent developments in the financial condition of Waterstone-Federal or WaterStone Bank or market conditions generally. In the event the independent valuation is updated to amend the pro forma market value

of New Waterstone to less than \$254.3 million or more than \$344.1 million, the appraisal will be filed with the Securities and Exchange Commission by a post-effective amendment to New Waterstone's registration statement.

The following table presents a summary of selected pricing ratios for New Waterstone (on a pro forma basis) based on earnings and other information as of and for the twelve months ended June 30, 2013 and the peer group companies based on earnings and other information as of and for the twelve months ended March 31, 2013, and stock price information for the peer group companies as of July 19, 2013, as reflected in the appraisal report. Compared to the average pricing of the peer group, our pro forma pricing ratios at the midpoint of the offering range indicated a discount of 28.7% on a price-to-book value basis, a discount of 31.7% on a price-to-tangible book value basis and a discount of 34.8% on a price-to-earnings basis. Our board of directors, in reviewing and approving the appraisal, considered the range of price-to-earnings multiples and the range of price-to-book value and price-to-tangible book value ratios at the different amounts of shares to be sold in the offering. The appraisal did not consider one valuation approach to be more important than the other. The estimated appraised value and the resulting premium/discount took into consideration the potential financial effect of the conversion and offering as well as the trading price of Waterstone-Federal's common stock. The closing price of the common stock was \$10.93 per share on July 19, 2013, the effective date of the appraisal, and \$7.77 per share on June 5, 2013, the last trading day immediately preceding the announcement of the conversion.

	Price-to-earnings multiple (1)	Price-to-book value ratio	Price-to-tangible book value ratio
New Waterstone (on a pro forma basis, assuming completion of the conversion)			
Maximum	20.19 x	81.23 %	81.38 %
Midpoint	17.40 x	75.70 %	75.81 %
Minimum	14.66 x	69.25 %	69.38 %
Valuation of peer group companies, all of which are fully converted (on an historical basis)			
Averages	26.67 x	106.18 %	111.04 %
Medians	28.78 x	106.77 %	110.01 %

(1) Price-to-earnings multiples calculated by RP Financial, LC. in the independent appraisal are based on an estimate of "core," or recurring, earnings on a trailing twelve-month basis through June 30, 2013 for New Waterstone and March 31, 2013 for the peer group companies. These ratios are different than those presented in "Pro Forma Data."

The independent valuation is not intended, and must not be construed, as a recommendation of any kind as to the advisability of purchasing our shares of common stock. RP Financial, LC. did not independently verify our consolidated financial statements and other information that we provided to them, nor did RP Financial, LC. independently value our assets or liabilities. The independent valuation considers WaterStone Bank as a going concern and should not be considered as an indication of the liquidation value of WaterStone Bank. Moreover, because the valuation is necessarily based upon estimates and projections of a number of matters, all of which may change from time to time, no assurance can be given that persons purchasing our common stock in the offering will thereafter be able to sell their shares at prices at or above the \$10.00 price per share.

We will not decrease the minimum of the valuation range and the minimum of the offering range or increase the maximum of the valuation range and the minimum of the offering range without a resolicitation of subscribers. The subscription price of \$10.00 per share will remain fixed.

If the update to the independent valuation at the conclusion of the offering results in an increase in the maximum of the valuation range to more than \$344.1 million and a corresponding increase in the offering range to more than 25,300,000 shares, or a decrease in the minimum of the valuation range to less than \$254.3 million and a corresponding decrease in the offering range to fewer than 18,700,000 shares, then we will promptly return with interest at 0.01% per annum all funds previously delivered to us to purchase shares of common stock in the subscription and community offerings and cancel deposit account withdrawal authorizations and, after consulting with the Federal Reserve Board, we may terminate the plan of conversion and reorganization. Alternatively, we may establish a new offering range, extend the offering period and commence a resolicitation of purchasers or take other actions as permitted by the Federal Reserve Board in order to complete the offering. In the event that we extend the offering and conduct a resolicitation due to a change in the independent valuation, we will notify subscribers of the extension of time and of the rights of subscribers to place a new stock order for a specified period



of time. Any single offering extension will not exceed 90 days; aggregate extensions may not conclude beyond December 27, 2015, which is two years after the special meeting of members to vote on the conversion.

An increase in the number of shares to be issued in the offering would decrease both a subscriber's ownership interest and New Waterstone's pro forma earnings and stockholders' equity on a per share basis while increasing stockholders' equity on an aggregate basis. A decrease in the number of shares to be issued in the offering would increase both a subscriber's ownership interest and New Waterstone's pro forma earnings and stockholders' equity on a per share basis, while decreasing stockholders' equity on an aggregate basis.

Copies of the independent valuation appraisal report of RP Financial, LC. and the detailed memorandum setting forth the method and assumptions used in the appraisal report are filed as exhibits to the documents specified under "Where You Can Find Additional Information."

#### Subscription Offering and Subscription Rights

In accordance with the plan of conversion and reorganization, rights to subscribe for shares of common stock in the subscription offering have been granted in the following descending order of priority. The filling of all subscriptions that we receive will depend on the availability of common stock after satisfaction of all subscriptions of all persons having prior rights in the subscription offering and on the purchase and ownership limitations set forth in the plan of conversion and reorganization and as described below under "—Additional Limitations on Common Stock Purchases."

**Priority 1: Eligible Account Holders.** Each depositor of WaterStone Bank with aggregate deposit account balances of \$50.00 or more (a "Qualifying Deposit") at the close of business on December 31, 2011 (an "Eligible Account Holder") will receive, without payment therefor, nontransferable subscription rights to purchase up to \$3.0 million (300,000 shares) of our common stock, subject to the overall purchase limitations. See "—Additional Limitations on Common Stock Purchases." If there are not sufficient shares available to satisfy all subscriptions, shares will first be allocated so as to permit each Eligible Account Holder to purchase a number of shares sufficient to make his or her total allocation equal to the lesser of 100 shares or the number of shares for which he or she subscribed. Thereafter, any remaining shares will be allocated to each Eligible Account Holder whose subscription remains unfilled in the proportion that the amount of his or her Qualifying Deposit bears to the total amount of Qualifying Deposits of all subscribing Eligible Account Holders whose subscriptions remain unfilled. If an amount so allocated exceeds the amount subscribed for by any one or more Eligible Account Holders, the excess shall be reallocated among those Eligible Account Holders whose subscriptions are not fully satisfied until all available shares have been allocated.

To ensure proper allocation of our shares of common stock, each Eligible Account Holder must list on his or her stock order form all deposit accounts in which he or she has an ownership interest on December 31, 2011. In the event of an oversubscription, failure to list an account could result in fewer shares being allocated than if all accounts had been disclosed. In the event of an oversubscription, the subscription rights of Eligible Account Holders who are also directors or executive officers of Waterstone-Federal or who are associates of such persons will be subordinated to the subscription rights of other Eligible Account Holders to the extent attributable to their increased deposits in the 12 months preceding December 31, 2011.

**Priority 2: Tax-Qualified Plans.** Our tax-qualified employee plans, including our employee stock ownership plan and 401(k) plan, will receive, without payment therefor, nontransferable subscription rights to purchase in the aggregate up to 10% of the shares of common stock sold in the offering, although our employee stock ownership plan intends to purchase 8% of the shares of common stock sold in the offering. If market conditions warrant, in the judgment of its

trustees, the employee stock ownership plan may instead elect to purchase shares in the open market following the completion of the conversion, subject to the approval of the Federal Reserve Board. The amount of the subscription requests by the 401(k) plan will be determined by its participants, who will have the right to invest all or a portion of their 401(k) plan accounts in our common stock, subject to the maximum purchase limitations. However, to comply with the limitations applicable to our tax-qualified

employee plans, our 401(k) plan may purchase no more than 2% of the shares of common stock sold in the offering.

**Priority 3: Supplemental Eligible Account Holders.** To the extent that there are sufficient shares of common stock remaining after satisfaction of subscriptions by Eligible Account Holders and our tax-qualified employee stock benefit plans, each depositor of WaterStone Bank with a Qualifying Deposit at the close of business on September 30, 2013 who is not an Eligible Account Holder (“Supplemental Eligible Account Holder”) will receive, without payment therefor, nontransferable subscription rights to purchase up to \$3.0 million (300,000 shares) of common stock, subject to the overall purchase limitations. See “—Additional Limitations on Common Stock Purchases.” If there are not sufficient shares available to satisfy all subscriptions, shares will be allocated so as to permit each Supplemental Eligible Account Holder to purchase a number of shares sufficient to make his or her total allocation equal to the lesser of 100 shares of common stock or the number of shares for which he or she subscribed. Thereafter, any remaining shares will be allocated to each Supplemental Eligible Account Holder whose subscription remains unfilled in the proportion that the amount of his or her Qualifying Deposit bears to the total amount of Qualifying Deposits of all Supplemental Eligible Account Holders whose subscriptions remain unfilled. If an amount so allocated exceeds the amount subscribed for by any one or more Supplemental Eligible Account Holders, the excess shall be reallocated among those Supplemental Eligible Account Holders whose subscriptions are not fully satisfied until all available shares have been allocated.

To ensure proper allocation of common stock, each Supplemental Eligible Account Holder must list on the stock order form all deposit accounts in which he or she has an ownership interest at September 30, 2013. In the event of an oversubscription, failure to list an account could result in fewer shares being allocated than if all accounts had been disclosed.

**Priority 4: Other Members.** To the extent that there are shares of common stock remaining after satisfaction of subscriptions by Eligible Account Holders, our tax-qualified employee stock benefit plans, and Supplemental Eligible Account Holders, each depositor of WaterStone Bank as of the close of business on October 31, 2013 who is not an Eligible Account Holder or Supplemental Eligible Account Holder (“Other Members”) will receive, without payment therefor, nontransferable subscription rights to purchase up to \$3.0 million (300,000 shares) of common stock, subject to the overall purchase limitations. See “—Additional Limitations on Common Stock Purchases.” If there are not sufficient shares available to satisfy all subscriptions, shares will be allocated so as to permit each Other Member to purchase a number of shares sufficient to make his or her total allocation equal to the lesser of 100 shares of common stock or the number of shares for which he or she subscribed. Thereafter, any remaining shares will be allocated in the proportion that the amount of the subscription of each Other Member bears to the total amount of the subscriptions of all Other Members whose subscriptions remain unsatisfied.

To ensure proper allocation of common stock, each Other Member must list on the stock order form all deposit accounts in which he or she had an ownership interest at October 31, 2013. In the event of an oversubscription, failure to list an account could result in fewer shares being allocated than if all accounts had been disclosed.

**Expiration Date.** The subscription offering will expire at 5:00 p.m., Central Time, on December 17, 2013, unless extended by us for up to 45 days or such additional periods with the approval of the Federal Reserve Board, if necessary. Subscription rights will expire whether or not each eligible depositor can be located. We may decide to extend the expiration date of the subscription offering for any reason, whether or not subscriptions have been received for shares at the minimum, midpoint or maximum of the offering range. Subscription rights which have not been exercised prior to the expiration date will become void.

We will not execute orders until at least the minimum number of shares of common stock have been sold in the offering. If at least 18,700,000 shares have not been sold in the offering by January 31, 2014 and the Federal Reserve Board has not consented to an extension, all funds delivered to us to purchase shares of common stock in the offering will be returned promptly, with interest at 0.01% per annum for funds received in the subscription and community offerings, and all deposit account withdrawal authorizations will be canceled. If an extension beyond

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January 31, 2014 is granted by the Federal Reserve Board, we will resolicit purchasers in the offering as described under “—Procedure for Purchasing Shares in Subscription and Community Offerings—Expiration Date.”

#### Community Offering

To the extent that shares of common stock remain available for purchase after satisfaction of all subscriptions of Eligible Account Holders, our tax-qualified employee stock benefit plans, Supplemental Eligible Account Holders and Other Members, we will offer shares pursuant to the plan of conversion and reorganization to members of the general public in a community offering. Shares will be offered in the community offering with the following preferences:

- (i) Natural persons (including trusts of natural persons) residing in Milwaukee, Washington and Waukesha Counties, Wisconsin;
- (ii) Waterstone-Federal’s public stockholders as of October 31, 2013; and
- (iii) Other members of the general public.

Subscribers in the community offering may purchase up to \$3.0 million (300,000 shares) of common stock, subject to the overall purchase limitations. See “—Additional Limitations on Common Stock Purchases.” The opportunity to purchase shares of common stock in the community offering category is subject to our right, in our sole discretion, to accept or reject any such orders in whole or in part either at the time of receipt of an order or as soon as practicable following the expiration date of the offering.

If we do not have sufficient shares of common stock available to fill the orders of natural persons (including trusts of natural persons) residing in Milwaukee, Washington and Waukesha Counties, Wisconsin, we will allocate the available shares among those persons in a manner that permits each of them, to the extent possible, to purchase the lesser of 100 shares or the number of shares subscribed for by such person. Thereafter, unallocated shares will be allocated among natural persons residing in those counties whose orders remain unsatisfied on an equal number of shares basis per order. If an oversubscription occurs due to the orders of public stockholders of Waterstone-Federal or members of the general public, the allocation procedures described above will apply to the stock orders of such persons. In connection with the allocation process, orders received for shares of common stock in the community offering will first be filled up to a maximum of 2% of the shares sold in the offering, and thereafter any remaining shares will be allocated on an equal number of shares basis per order until all shares have been allocated.

The term “residing” or “resident” as used in this proxy statement/prospectus means any person who occupies a dwelling within Milwaukee, Washington and Waukesha Counties, Wisconsin, has a present intent to remain within this community for a period of time, and manifests the genuineness of that intent by establishing an ongoing physical presence within the community, together with an indication that this presence within the community is something other than merely transitory in nature. We may utilize deposit or loan records or other evidence provided to us to decide whether a person is a resident. In all cases, however, the determination shall be in our sole discretion.

Expiration Date. The community offering will begin concurrently with the subscription offering, and is currently expected to terminate at the same time as the subscription offering, and must terminate no more than 45 days following the subscription offering, unless extended. New Waterstone may decide to extend the community offering for any reason and is not required to give purchasers notice of any such extension unless such period extends beyond January 31, 2014, in which event we will resolicit purchasers.

Syndicated or Firm Commitment Underwritten Offering

If feasible, our board of directors may decide to offer for sale shares of common stock not subscribed for or purchased in the subscription and community offerings in a syndicated or firm commitment underwritten

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offering, subject to such terms, conditions and procedures as we may determine, in a manner that will achieve a wide distribution of our shares of common stock.

If a syndicated or firm commitment underwritten offering is held, Sandler O'Neill & Partners, L.P. will serve as sole book-running manager and Robert W. Baird & Co. Incorporated will serve as co-manager. In the event that shares of common stock are sold in a syndicated or firm commitment underwritten offering, we will pay fees of 5% of the aggregate amount of common stock sold in the syndicated or firm commitment underwritten offering to Sandler O'Neill & Partners, L.P. and any other broker-dealers included in the syndicated or firm commitment underwritten offering. The shares of common stock will be sold at the same price per share (\$10.00 per share) that the shares are sold in the subscription offering and the community offering.

In the event of a syndicated offering, it is currently expected that investors would follow the same general procedures applicable to purchasing shares in the subscription and community offerings (the use of order forms and the submission of funds directly to New Waterstone for the payment of the purchase price of the shares ordered) except that payment must be in immediately available funds (bank checks, money orders, deposit account withdrawals from accounts at WaterStone Bank or wire transfers). See “—Procedure for Purchasing Shares in Subscription and Community Offerings.” “Sweep” arrangements and delivery versus payment settlement will only be used in a syndicated offering to the extent consistent with Rules 10b-9 and 15c2-4 and then-existing guidance and interpretations thereof of the Securities and Exchange Commission regarding the conduct of “min/max” offerings.

In the event of a firm commitment underwritten offering, the proposed underwriting agreement will not be entered into with Sandler O'Neill & Partners, L.P., Robert W. Baird & Co. Incorporated and New Waterstone, WaterStone Bank, Waterstone-Federal and Lamplighter Financial, MHC until immediately prior to the completion of the firm commitment underwritten offering. At that time, Sandler O'Neill & Partners, L.P., Robert W. Baird & Co. Incorporated and any other broker-dealers included in the firm commitment underwritten offering will represent that they have received sufficient indications of interest to complete the offering. Pursuant to the terms of the underwriting agreement, and subject to certain customary provisions and conditions to closing, upon execution of the underwriting agreement, Sandler O'Neill & Partners, L.P., Robert W. Baird & Co. Incorporated and any other underwriters will be obligated to purchase all the shares subject to the firm commitment underwritten offering.

If for any reason we cannot effect a syndicated or firm commitment underwritten offering of shares of common stock not purchased in the subscription and community offerings, or in the event that there are an insignificant number of shares remaining unsold after such offerings, we will try to make other arrangements for the sale of unsubscribed shares. The Federal Reserve Board and the Financial Industry Regulatory Authority must approve any such arrangements.

#### Additional Limitations on Common Stock Purchases

The plan of conversion and reorganization includes the following additional limitations on the number of shares of common stock that may be purchased in the offering:

- (i) No person may purchase fewer than 25 shares of common stock;
- (ii) Tax qualified employee benefit plans, including our employee stock ownership plan and 401(k) plan, may purchase in the aggregate up to 10% of the shares of common stock issued in the offering;

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- (iii) Except for the employee stock ownership plan and 401(k) plan, as described above, no person or entity, together with associates or persons acting in concert with such person or entity, may purchase more than \$3.0 million (300,000 shares) of common stock in all categories of the offering combined;
- (iv) Current stockholders of Waterstone-Federal are subject to an ownership limitation. As previously described, current stockholders of Waterstone-Federal will receive shares of New Waterstone



common stock in exchange for their existing shares of Waterstone-Federal common stock. The number of shares of common stock that a stockholder may purchase in the offering, together with associates or persons acting in concert with such stockholder, when combined with the shares that the stockholder and his or her associates will receive in exchange for existing Waterstone-Federal common stock, may not exceed 9.9% of the shares of common stock of New Waterstone to be issued and outstanding at the completion of the conversion; and

- (v) The maximum number of shares of common stock that may be purchased in all categories of the offering by executive officers and directors of WaterStone Bank and their associates, in the aggregate, when combined with shares of common stock issued in exchange for existing shares, may not exceed 25% of the total shares issued in the conversion.

Depending upon market or financial conditions, our board of directors, with the approval of the Federal Reserve Board and without further approval of members of Lamplighter Financial, MHC, may decrease or increase the purchase limitations. If a purchase limitation is increased, subscribers in the subscription offering who ordered the maximum amount will be given the opportunity to increase their orders up to the then applicable limit. The effect of this type of resolicitation will be an increase in the number of shares of common stock owned by persons who choose to increase their orders. In the event that the maximum purchase limitation is increased to 5% of the shares sold in the offering, such limitation may be further increased to 9.99%, provided that orders for shares of common stock exceeding 5% of the shares sold in the offering shall not exceed in the aggregate 10% of the total shares sold in the offering.

The term “associate” of a person means:

- (i) any corporation or organization, other than Waterstone-Federal, WaterStone Bank or a majority-owned subsidiary of WaterStone Bank, of which the person is a senior officer, partner or 10% beneficial stockholder;
- (ii) any trust or other estate in which the person has a substantial beneficial interest or serves as a trustee or in a similar fiduciary capacity; provided, however, it does not include any employee stock benefit plan in which the person has a substantial beneficial interest or serves as trustee or in a similar fiduciary capacity; and
- (iii) any blood or marriage relative of the person, who either has the same home as the person or who is a director or officer of Waterstone-Federal or WaterStone Bank.

The term “acting in concert” means:

- (i) knowing participation in a joint activity or interdependent conscious parallel action towards a common goal whether or not pursuant to an express agreement; or
- (ii) a combination or pooling of voting or other interests in the securities of an issuer for a common purpose pursuant to any contract, understanding, relationship, agreement or other arrangement, whether written or otherwise.

A person or company that acts in concert with another person or company (“other party”) will also be deemed to be acting in concert with any person or company who is also acting in concert with that other party, except that any tax-qualified employee stock benefit plan will not be deemed to be acting in concert with its trustee or a person who serves in a similar capacity solely for determining whether common stock held by the trustee and common stock held by the employee stock benefit plan will be aggregated.

We have the sole discretion to determine whether prospective purchasers are “associates” or “acting in concert.” Persons having the same address, and persons exercising subscription rights through qualifying deposits registered at the same address will be deemed to be acting in concert unless we determine otherwise.

Our directors are not treated as associates of each other solely because of their membership on the board of directors. Common stock purchased in the offering will be freely transferable except for shares purchased by directors and certain officers of New Waterstone or WaterStone Bank and except as described below. Any purchases made by any associate of New Waterstone or WaterStone Bank for the explicit purpose of meeting the minimum number of shares of common stock required to be sold in order to complete the offering shall be made for investment purposes only and not with a view toward redistribution. In addition, under Financial Industry Regulatory Authority guidelines, members of the Financial Industry Regulatory Authority and their associates are subject to certain restrictions on transfer of securities purchased in accordance with subscription rights and to certain reporting requirements upon purchase of these securities. For a further discussion of limitations on purchases of our shares of common stock at the time of conversion and thereafter, see “—Certain Restrictions on Purchase or Transfer of Our Shares after Conversion” and “Restrictions on Acquisition of New Waterstone.”

#### Plan of Distribution; Selling Agent and Underwriter Compensation

**Subscription and Community Offerings.** To assist in the marketing of our shares of common stock in the subscription and community offerings, we have retained Sandler O’Neill & Partners, L.P., which is a broker-dealer registered with the Financial Industry Regulatory Authority. Sandler O’Neill & Partners, L.P. will assist us on a best efforts basis in the subscription and community offerings by:

- (i) consulting as to the financial and marketing implications of the plan of conversion and reorganization;
- (ii) reviewing with our board of directors the financial effect of the offering on us, based on the independent appraiser’s appraisal of the shares of common stock;
- (iii) reviewing all offering documents, including the prospectus for the subscription and community offering and any prospectus related to a syndicated or firm commitment underwritten offering, stock order forms and related offering materials;
- (iv) assisting in the design and implementation of a marketing strategy for the offering;
- (v) assisting management in scheduling and preparing for meetings with potential investors and other broker-dealers in connection with the offering; and
- (vi) providing such other general advice and assistance as may be reasonably necessary to promote the successful completion of the offerings.

For these services, Sandler O’Neill & Partners, L.P. will receive a fee of 1.0% of the dollar amount of all shares of common stock sold in the subscription and community offerings. No fee will be payable to Sandler O’Neill & Partners, L.P. with respect to shares purchased by officers, directors, employees or their immediate families and shares purchased by our tax-qualified and non-qualified employee benefit plans, and no sales fee will be payable with respect to the exchange shares.

**Syndicated or Firm Commitment Underwritten Offering.** In the event that shares of common stock are sold in a syndicated or firm commitment underwritten offering, we will pay fees of 5% of the aggregate amount of common stock sold in the syndicated or firm commitment underwritten offering to Sandler O’Neill & Partners, L.P., Robert W. Baird & Co. Incorporated and any other broker-dealers included in the syndicated or firm commitment underwritten offering.

Expenses. Sandler O'Neill & Partners, L.P. also will be reimbursed for reasonable expenses, including legal fees, in an amount not to exceed \$115,000. If the plan of conversion is terminated or if Sandler O'Neill & Partners, L.P.'s engagement is terminated in accordance with the provisions of the agency agreement, Sandler O'Neill & Partners, L.P. will only receive reimbursement of its reasonable out-of-pocket expenses and will return

any amounts paid or advanced by us in excess of these amounts. We have separately agreed to pay Sandler O'Neill & Partners, L.P. up to \$60,000 in fees and expenses for records management, as described below.

#### Records Management

We have also engaged Sandler O'Neill & Partners, L.P. as records management agent in connection with the conversion and the subscription and community offerings. In its role as records management agent, Sandler O'Neill & Partners, L.P., will assist us in the offering in the:

- consolidation of deposit accounts and vote calculations;
- design and preparation of proxy and stock order forms;
- organization and supervision of the Stock Information Center;
- proxy solicitation and other services for our special meeting of members; and
- preparation and processing of other documents related to the stock offering.

Sandler O'Neill & Partners, L.P. will receive fees of \$30,000 and reimbursement for expenses of up to \$30,000 for these services. Such fees may be increased by up to an additional \$30,000 in the event of material delay or similar changes that result in extra charges. Of the fees for records management, \$15,000 has been paid as of the date of this proxy statement/prospectus.

#### Indemnity

We will indemnify Sandler O'Neill & Partners, L.P. against liabilities and expenses, including legal fees, incurred in connection with certain claims or litigation arising out of or based upon untrue statements or omissions contained in the offering materials for the common stock, including liabilities under the Securities Act of 1933, as amended.

#### Solicitation of Offers by Officers and Directors

Some of our directors and executive officers may participate in the solicitation of offers to purchase common stock in the subscription and community offerings. These persons will be reimbursed for their reasonable out-of-pocket expenses incurred in connection with the solicitation. Other regular employees of WaterStone Bank may assist in the offering, but only in ministerial capacities, and may provide clerical work in effecting a sales transaction. No offers or sales may be made by tellers or at the teller counters. Investment-related questions of prospective purchasers will be directed to executive officers or registered representatives of Sandler O'Neill & Partners, L.P. Our other employees have been instructed not to solicit offers to purchase shares of common stock or provide advice regarding the purchase of common stock. We will rely on Rule 3a4-1 under the Securities Exchange Act of 1934, as amended, and sales of common stock will be conducted within the requirements of Rule 3a4-1, so as to permit officers, directors and employees to participate in the sale of common stock. None of our officers, directors or employees will be compensated in connection with their participation in the offering.

#### Lock-up Agreements

We, and each of our directors and executive officers have agreed, subject to certain exceptions, that during the period beginning on the date of the prospectus for the subscription and community offering and ending 90 days after the closing of the offering, without the prior written consent of Sandler O'Neill & Partners, L.P., directly or indirectly, we will not (i) offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant for the sale of, or otherwise dispose of or transfer any shares of Waterstone-Federal or New Waterstone stock or any securities convertible into or exchangeable or exercisable for Waterstone-Federal or New Waterstone stock, whether owned on the date of the prospectus or

acquired after the date of the prospectus or with respect to which we or any of our directors or executive officers has or after the date of the prospectus acquires the power of disposition, or file any registration statement under the Securities Act of 1933, as amended, with respect to any of the foregoing, or (ii) enter into any swap or any other agreement or any transaction that transfers, in whole or in part, directly or indirectly, the economic consequence of ownership of Waterstone-Federal or New Waterstone stock, whether any such swap or transaction is to be settled by delivery of stock or other securities, in cash or otherwise. In the event that either (1) during the period that begins on the date that is 15 calendar days plus three business days before the last day of the restricted period and ends on the last day of the restricted period, we issue an earnings release or material news or a material event relating to us occurs, or (2) prior to the expiration of the restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the restricted period, the restrictions set forth above will continue to apply until the expiration of the date that is 15 calendar days plus three business days after the date on which the earnings release is issued or the material news or event related to us occurs.

#### Procedure for Purchasing Shares in Subscription and Community Offerings

**Expiration Date.** The subscription and community offerings will expire at 5:00 p.m., Central Time, on December 17, 2013, unless we extend one or both for up to 45 days, with the approval of the Federal Reserve Board, if required. This extension may be approved by us, in our sole discretion, without notice to purchasers in the offering. Any extension of the subscription and/or community offering beyond January 31, 2014 would require the Federal Reserve Board's approval. If the offering is so extended, all subscribers will be notified and given an opportunity to confirm, change or cancel their orders. If you do not respond to this notice, we will promptly return your funds with interest at 0.01% per annum or cancel your deposit account withdrawal authorization. If the offering range is decreased below the minimum of the offering range or is increased above the maximum of the offering range, all subscribers' stock orders will be cancelled, their deposit account withdrawal authorizations will be cancelled, and funds submitted to us will be returned promptly, with interest at 0.01% per annum for funds received in the subscription and community offerings. We will then resolicit the subscribers, giving them an opportunity to place a new stock order for a period of time.

We reserve the right in our sole discretion to terminate the offering at any time and for any reason, in which case we will cancel any deposit account withdrawal authorizations and promptly return all funds submitted, with interest at 0.01% per annum from the date of receipt as described above.

**Use of Order Forms in the Subscription and Community Offerings.** In order to purchase shares of common stock in the subscription and community offerings, you must properly complete an original stock order form and remit full payment. We are not required to accept orders submitted on photocopied or facsimiled order forms. All order forms must be received (not postmarked) prior to 5:00 p.m., Central Time, on December 17, 2013. We are not required to accept order forms that are not received by that time, are not signed or are otherwise executed defectively or are received without full payment or without appropriate deposit account withdrawal instructions. We are not required to notify subscribers of incomplete or improperly executed order forms, and we have the right to waive or permit the correction of incomplete or improperly executed order forms. We do not represent, however, that we will do so and we have no affirmative duty to notify any prospective subscriber of any such defects. You may submit your order form and payment by mail using the stock order return envelope provided, or by overnight delivery to our Stock Information Center, which will be located at 6560 South 27th Street, Oak Creek, Wisconsin 53154. You may also hand-deliver stock order forms to the Stock Information Center. Hand-delivered stock order forms will only be accepted at this location. We will not accept stock order forms at our banking offices. Please do not mail stock order forms to WaterStone Bank's or Waterstone Mortgage Corporation's offices.

Once tendered, an order form cannot be modified or revoked without our consent. We reserve the absolute right, in our sole discretion, to reject orders received in the community offering, in whole or in part, at the time of receipt or at any time prior to completion of the offering. If you are ordering shares in the subscription offering, you must represent that you are purchasing shares for your own account and that you have no agreement or understanding with any person for the sale or transfer of the shares. We have the right to reject any order submitted in the offering by a person who we believe is making false representations or who we otherwise believe, either alone or acting in concert with others, is violating, evading, circumventing, or intends to violate, evade or circumvent the



terms and conditions of the plan of conversion and reorganization. Our interpretation of the terms and conditions of the plan of conversion and reorganization and of the acceptability of the order forms will be final.

By signing the order form, you will be acknowledging that the common stock is not a deposit or savings account and is not federally insured or otherwise guaranteed by WaterStone Bank or the federal government, and that you received a copy of the prospectus. However, signing the order form will not result in you waiving your rights under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Payment for Shares. Payment for all shares of common stock will be required to accompany all completed order forms for the purchase to be valid. Payment for shares in the subscription and community offerings may be made by:

- (i) personal check, bank check or money order, made payable to Waterstone Financial, Inc.; or
- (ii) authorization of withdrawal of available funds from your WaterStone Bank deposit accounts.

Appropriate means for designating withdrawals from deposit accounts at WaterStone Bank are provided on the order form. The funds designated must be available in the account(s) at the time the order form is received. A hold will be placed on these funds, making them unavailable to the depositor. Funds authorized for withdrawal will continue to earn interest within the account at the contractual rate until the offering is completed, at which time the designated withdrawal will be made. Interest penalties for early withdrawal applicable to certificate accounts will not apply to withdrawals authorized for the purchase of shares of common stock; however, if a withdrawal results in a certificate account with a balance less than the applicable minimum balance requirement, the certificate will be canceled at the time of withdrawal without penalty and the remaining balance will earn interest at the current passbook rate subsequent to the withdrawal. In the case of payments made by personal check, these funds must be available in the account(s). Checks and money orders received in the subscription and community offerings will be immediately cashed and placed in a segregated account at WaterStone Bank and will earn interest at 0.01% per annum from the date payment is processed until the offering is completed or terminated.

You may not remit cash, WaterStone Bank line of credit checks or any type of third-party checks (including those payable to you and endorsed over to New Waterstone). You may not designate on your stock order form direct withdrawal from a WaterStone Bank retirement account. See “—Using Individual Retirement Account Funds.” If permitted by the Federal Reserve Board, in the event we resolicit large purchasers, as described above in “—Additional Limitations on Common Stock Purchases,” such purchasers who wish to increase their purchases will not be able to use personal checks to pay for the additional shares, but instead must pay for the additional shares using immediately available funds.

Once we receive your executed stock order form, it may not be modified, amended or rescinded without our consent, unless the offering is not completed by January 31, 2014. If the subscription and community offerings are extended past January 31, 2014, all subscribers will be notified and given an opportunity to confirm, change or cancel their orders. If you do not respond to this notice, we will promptly return your funds with interest at 0.01% per annum or cancel your deposit account withdrawal authorization. We may resolicit purchasers for a specified period of time.

Regulations prohibit WaterStone Bank from lending funds or extending credit to any persons to purchase shares of common stock in the offering.

We shall have the right, in our sole discretion, to permit institutional investors to submit irrevocable orders together with the legally binding commitment for payment and to thereafter pay for the shares of common stock for which they subscribe in the community offering at any time prior to 48 hours before the completion of the conversion. This payment may be made by wire transfer.

If our employee stock ownership plan purchases shares in the offering, it will not be required to pay for such shares until completion of the offering, provided that there is a loan commitment from an unrelated financial

institution or New Waterstone to lend to the employee stock ownership plan the necessary amount to fund the purchase. In addition, if our 401(k) plan purchases shares in the offering, it will not be required to pay for such shares until completion of the offering.

**Using Individual Retirement Account Funds.** If you are interested in using funds in your individual retirement account or other retirement account to purchase shares of common stock, you must do so through a self-directed retirement account. By regulation, WaterStone Bank's retirement accounts are not self-directed, so they cannot be invested in our shares of common stock. Therefore, if you wish to use funds that are currently in a WaterStone Bank retirement account, you may not designate on the order form that you wish funds to be withdrawn from the account for the purchase of common stock. The funds you wish to use for the purchase of common stock will instead have to be transferred to an independent trustee or custodian, such as a brokerage firm, offering self-directed retirement accounts. The purchase must be made through that account. If you do not have such an account, you will need to establish one before placing a stock order. An annual administrative fee may be payable to the independent trustee or custodian. There will be no early withdrawal or Internal Revenue Service interest penalties for these transfers. Individuals interested in using funds in an individual retirement account or any other retirement account, whether held at WaterStone Bank or elsewhere, to purchase shares of common stock should contact our Stock Information Center for guidance as soon as possible, preferably at least two weeks prior to the December 17, 2013 offering deadline. Processing such transactions takes additional time, and whether such funds can be used may depend on limitations imposed by the institutions where such funds are currently held. We cannot guarantee that you will be able to use such funds.

**Delivery of Shares of Common Stock.** All shares of common stock sold will be issued in book entry form. Stock certificates will not be issued. A statement reflecting ownership of shares of common stock issued in the subscription and community offerings will be mailed by our transfer agent to the persons entitled thereto at the registration address noted by them on their stock order forms as soon as practicable following consummation of the conversion and offering. We expect trading in the stock to begin on the day of completion of the conversion and stock offering or the next business day. It is possible that until a statement reflecting ownership of shares of common stock is available and delivered to purchasers, purchasers might not be able to sell the shares of common stock that they ordered, even though the shares of common stock will have begun trading. Your ability to sell the shares of common stock before receiving your statement will depend on arrangements you may make with a brokerage firm.

**Other Restrictions.** Notwithstanding any other provision of the plan of conversion and reorganization, no person is entitled to purchase any shares of common stock to the extent the purchase would be illegal under any federal or state law or regulation, including state "blue sky" regulations, or would violate regulations or policies of the Financial Industry Regulatory Authority, particularly those regarding free riding and withholding. We may ask for an acceptable legal opinion from any purchaser as to the legality of his or her purchase and we may refuse to honor any purchase order if an opinion is not timely furnished. In addition, we are not required to offer shares of common stock to any person who resides in a foreign country, or in a State of the United States with respect to which any of the following apply:

- (i) a small number of persons otherwise eligible to subscribe for shares under the plan of conversion and reorganization reside in such state;
- (ii) the issuance of subscription rights or the offer or sale of shares of common stock to such persons would require us, under the securities laws of such state, to register as a broker, dealer, salesman or agent or to register or otherwise qualify our securities for sale in such state; or

- (iii) such registration or qualification would be impracticable for reasons of cost or otherwise.

#### Exchange of Existing Stockholders' Stock Certificates

The conversion of existing outstanding shares of Waterstone-Federal common stock into the right to receive shares of New Waterstone common stock will occur automatically at the completion of the conversion. As

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soon as practicable after the completion of the conversion, our exchange agent will send a transmittal form to each public stockholder of Waterstone-Federal who holds physical stock certificates. The transmittal form will contain instructions on how to surrender certificates evidencing Waterstone-Federal common stock in exchange for shares of New Waterstone common stock in book entry form, to be held electronically on the books of our transfer agent. New Waterstone will not issue stock certificates. We expect that a statement reflecting your ownership of shares of common stock of New Waterstone common stock will be distributed within five business days after the exchange agent receives properly executed transmittal forms, Waterstone-Federal stock certificates and other required documents. Shares held by public stockholders in street name (such as in a brokerage account) will be exchanged automatically upon the completion of the conversion; no transmittal forms will be mailed relating to these shares.

No fractional shares of New Waterstone common stock will be issued to any public stockholder of Waterstone-Federal when the conversion is completed. For each fractional share that would otherwise be issued to a stockholder who holds a stock certificate, we will pay by check an amount equal to the product obtained by multiplying the fractional share interest to which the holder would otherwise be entitled by the \$10.00 offering purchase price per share. Payment for fractional shares will be made as soon as practicable after the receipt by the exchange agent of the transmittal forms and the surrendered Waterstone-Federal stock certificates. If your shares of common stock are held in street name, you will automatically receive cash in lieu of fractional shares in your account.

You should not forward your stock certificates until you have received transmittal forms, which will include forwarding instructions. After the conversion, stockholders will not receive shares of New Waterstone common stock and will not be paid dividends on the shares of New Waterstone common stock until existing certificates representing shares of Waterstone-Federal common stock are surrendered for exchange in compliance with the terms of the transmittal form. When stockholders surrender their certificates, any unpaid dividends will be paid without interest. For all other purposes, however, each certificate that represents shares of Waterstone-Federal common stock outstanding at the effective date of the conversion will be considered to evidence ownership of shares of New Waterstone common stock into which those shares have been converted by virtue of the conversion.

If a certificate for Waterstone-Federal common stock has been lost, stolen or destroyed, our exchange agent will issue a new stock certificate upon receipt of appropriate evidence as to the loss, theft or destruction of the certificate, appropriate evidence as to the ownership of the certificate by the claimant, and appropriate and customary indemnification, which is normally effected by the purchase of a bond from a surety company at the stockholder's expense.

All shares of New Waterstone common stock that we issue in exchange for existing shares of Waterstone-Federal common stock will be considered to have been issued in full satisfaction of all rights pertaining to such shares of common stock, subject, however, to our obligation to pay any dividends or make any other distributions with a record date prior to the effective date of the conversion that may have been declared by us on or prior to the effective date, and which remain unpaid at the effective date.

#### Restrictions on Transfer of Subscription Rights and Shares

Regulations of the Federal Reserve Board prohibit any person with subscription rights, including the Eligible Account Holders, Supplemental Eligible Account Holders and Other Members, from transferring or entering into any agreement or understanding to transfer the legal or beneficial ownership of the subscription rights issued under the plan of conversion and reorganization or the shares of common stock to be issued upon their exercise. These rights may be exercised only by the person to whom they are granted and only for his or her account. When registering your

stock purchase on the order form, you cannot add the name(s) of others for joint stock registration unless they are also named on the qualifying deposit account. Doing so may jeopardize your subscription rights. Each person exercising subscription rights will be required to certify that he or she is purchasing shares solely for his or her own account and that he or she has no agreement or understanding regarding the sale or transfer of such shares. The regulations also prohibit any person from offering or making an announcement of an offer or intent to make an offer to purchase subscription rights or shares of common stock to be issued upon their exercise prior to completion of the offering.

We will pursue any and all legal and equitable remedies in the event we become aware of the transfer of subscription rights, and we will not honor orders that we believe involve the transfer of subscription rights.

#### Stock Information Center

Our banking office personnel may not, by law, assist with investment-related questions about the offering. If you have any questions regarding the conversion or offering, please call our Stock Information Center. The telephone number is (414) 459-4700. The Stock Information Center is open Monday through Friday between 10:00 a.m. and 4:00 p.m., Central Time. The Stock Information Center will be closed on weekends and bank holidays.

#### Liquidation Rights

**Liquidation prior to the conversion.** In the unlikely event that Lamplighter Financial, MHC is liquidated prior to the conversion, all claims of creditors of Lamplighter Financial, MHC would be paid first. Thereafter, if there were any assets of Lamplighter Financial, MHC remaining, these assets would first be distributed to certain depositors of WaterStone Bank based on such depositors' liquidation rights. The amount received by such depositors would be equal to their pro rata interest in the remaining value of Lamplighter Financial, MHC after claims of creditors, based on the relative size of their deposit accounts.

**Liquidation following the conversion.** The plan of conversion and reorganization provides for the establishment, upon the completion of the conversion, of a liquidation account by New Waterstone for the benefit of Eligible Account Holders and Supplemental Eligible Account Holders in an amount equal to (i) Lamplighter Financial, MHC's ownership interest in Waterstone-Federal's total stockholders' equity as of the date of the latest statement of financial condition used in New Waterstone's prospectus for the stock offering plus (ii) the value of the net assets of Lamplighter Financial, MHC as of the date of the latest statement of financial condition of Lamplighter Financial, MHC prior to the consummation of the conversion (excluding its ownership of Waterstone-Federal). The plan of conversion also provides for the establishment of a parallel liquidation account in WaterStone Bank to support the New Waterstone liquidation account in the event New Waterstone does not have sufficient assets to fund its obligations under the New Waterstone liquidation account.

In the unlikely event that WaterStone Bank were to liquidate after the conversion, all claims of creditors, including those of depositors, would be paid first. However, except with respect to the liquidation account to be established in Waterstone-Federal, a depositor's claim would be solely for the principal amount of his or her deposit accounts plus accrued interest. Depositors generally would not have an interest in the value of the assets of WaterStone Bank or New Waterstone above that amount.

The liquidation account established by New Waterstone is designed to provide qualifying depositors a liquidation interest (exchanged for the liquidation interests such persons had in Lamplighter Financial, MHC) after the conversion in the event of a complete liquidation of New Waterstone and WaterStone Bank or a liquidation solely of WaterStone Bank. Specifically, in the unlikely event that either (i) WaterStone Bank or (ii) New Waterstone and WaterStone Bank were to liquidate after the conversion, all claims of creditors, including those of depositors, would be paid first, followed by a distribution to depositors as of December 31, 2011 and September 30, 2013 of their interests in the liquidation account maintained by New Waterstone. Also, in a complete liquidation of both entities, or of WaterStone Bank only, when New Waterstone has insufficient assets (other than the stock of WaterStone Bank) to fund the liquidation account distribution owed to Eligible Account Holders and Supplemental Eligible Account Holders, and WaterStone Bank has positive net worth, then WaterStone Bank shall immediately make a distribution to fund New Waterstone's remaining obligations under the liquidation account. In no event will any Eligible Account Holder or

Supplemental Eligible Account Holder be entitled to a distribution that exceeds such holder's interest in the liquidation account maintained by New Waterstone as adjusted from time to time pursuant to the plan of conversion and federal regulations. If New Waterstone is completely liquidated or sold apart from a sale or liquidation of WaterStone Bank, then the New Waterstone liquidation account will cease to exist and Eligible Account Holders and Supplemental Eligible Account Holders will receive an equivalent interest in the WaterStone Bank liquidation account, subject to the same rights and terms as the New Waterstone liquidation account.



Pursuant to the plan of conversion and reorganization, after two years from the date of conversion and upon the written request of the Board of Governors of the Federal Reserve System, New Waterstone will transfer the liquidation account and the depositors' interests in such account to WaterStone Bank and the liquidation account shall thereupon be subsumed into the liquidation account of WaterStone Bank.

Under the rules and regulations of the Federal Reserve Board, a post-conversion merger, consolidation, or similar combination or transaction with another depository institution or depository institution holding company in which New Waterstone or WaterStone Bank is not the surviving institution, would not be considered a liquidation. In such a transaction, the liquidation account would be assumed by the surviving institution or company.

Each Eligible Account Holder and Supplemental Eligible Account Holder would have an initial pro-rata interest in the liquidation account for each deposit account, including savings accounts, transaction accounts such as negotiable order of withdrawal accounts, money market deposit accounts, and certificates of deposit, with a balance of \$50.00 or more held in WaterStone Bank on December 31, 2011 or September 30, 2013 equal to the proportion that the balance of each Eligible Account Holder's and Supplemental Eligible Account Holder's deposit account on December 31, 2011 and September 30, 2013, respectively, bears to the balance of all deposit accounts of Eligible Account Holders and Supplemental Eligible Account Holders in WaterStone Bank on such date.

If, however, on any December 31 annual closing date commencing after the effective date of the conversion, the amount in any such deposit account is less than the amount in the deposit account on December 31, 2011 or September 30, 2013, or any other annual closing date, then the liquidation account as well as the interest in the liquidation account relating to such deposit account would be reduced from time to time by the proportion of any such reduction, and such interest will cease to exist if such deposit account is closed. In addition, no interest in the liquidation account would ever be increased despite any subsequent increase in the related deposit account. Payment pursuant to liquidation rights of Eligible Account Holders and Supplemental Eligible Account Holders would be separate and apart from the payment of any insured deposit accounts to such depositor. Any assets remaining after the above liquidation rights of Eligible Account Holders and Supplemental Eligible Account Holders are satisfied would be available for distribution to stockholders.

#### Material Income Tax Consequences

Completion of the conversion is subject to the prior receipt of an opinion of counsel or tax advisor with respect to the federal and state income tax consequences of the conversion to Lamplighter Financial, MHC, Waterstone-Federal, WaterStone Bank, Eligible Account Holders, Supplemental Eligible Account Holders and Other Members of Lamplighter Financial, MHC. Unlike private letter rulings, opinions of counsel or tax advisors are not binding on the Internal Revenue Service or any state taxing authority, and such authorities may disagree with such opinions. In the event of such disagreement, there can be no assurance that New Waterstone or WaterStone Bank would prevail in a judicial proceeding.

Lamplighter Financial, MHC, Waterstone-Federal, WaterStone Bank and New Waterstone have received an opinion of counsel, Luse Gorman Pomerenk & Schick, P.C., regarding all of the material federal income tax consequences of the conversion, which includes the following:

1. The merger of Lamplighter Financial, MHC with and into Waterstone-Federal will qualify as a tax-free reorganization within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code.
- 2.

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The constructive exchange of Eligible Account Holders' and Supplemental Eligible Account Holders' liquidation interests in Lamplighter Financial, MHC for liquidation interests in Waterstone-Federal will satisfy the continuity of interest requirement of Section 1.368-1(b) of the Federal Income Tax Regulations.

3. None of Lamplighter Financial, MHC, Waterstone-Federal, Eligible Account Holders nor Supplemental Eligible Account Holders, will recognize any gain or loss on the transfer of the

assets of Lamplighter Financial, MHC to Waterstone-Federal in constructive exchange for liquidation interests in Waterstone-Federal.

4. The basis of the assets of Lamplighter Financial, MHC and the holding period of such assets to be received by Waterstone-Federal will be the same as the basis and holding period of such assets in Lamplighter Financial, MHC immediately before the exchange.
5. The merger of Waterstone-Federal with and into New Waterstone will constitute a mere change in identity, form or place of organization within the meaning of Section 368(a)(1)(F) of the Internal Revenue Code and, therefore, will qualify as a tax-free reorganization within the meaning of Section 368(a)(1)(F) of the Internal Revenue Code. Neither Waterstone-Federal nor New Waterstone will recognize gain or loss as a result of such merger.
6. The basis of the assets of Waterstone-Federal and the holding period of such assets to be received by New Waterstone will be the same as the basis and holding period of such assets in Waterstone-Federal immediately before the exchange.
7. Current stockholders of Waterstone-Federal will not recognize any gain or loss upon their exchange of Waterstone-Federal common stock for New Waterstone common stock.
8. Eligible Account Holders and Supplemental Eligible Account Holders will not recognize any gain or loss upon the constructive exchange of their liquidation interests in Waterstone-Federal for interests in the liquidation account in New Waterstone.
9. The exchange by the Eligible Account Holders and Supplemental Eligible Account Holders of the liquidation interests that they constructively received in Waterstone-Federal for interests in the liquidation account established in New Waterstone will satisfy the continuity of interest requirement of Section 1.368-1(b) of the Federal Income Tax Regulations.
10. Each stockholder's aggregate basis in shares of New Waterstone common stock (including fractional share interests) received in the exchange will be the same as the aggregate basis of Waterstone-Federal common stock surrendered in the exchange.
  11. Each stockholder's holding period in his or her New Waterstone common stock received in the exchange will include the period during which the Waterstone-Federal common stock surrendered was held, provided that the Waterstone-Federal common stock surrendered is a capital asset in the hands of the stockholder on the date of the exchange.
  12. Cash received by any current stockholder of Waterstone-Federal in lieu of a fractional share interest in shares of New Waterstone common stock will be treated as having been received as a distribution in full payment in exchange for a fractional share interest of New Waterstone common stock, which such stockholder would otherwise be entitled to receive. Accordingly, a stockholder will recognize gain or loss equal to the difference between the cash received and the basis of the fractional share. If the common stock is held by the stockholder as a capital asset, the gain or loss will be capital gain or loss.
13. It is more likely than not that the fair market value of the nontransferable subscription rights to purchase New Waterstone common stock is zero. Accordingly, no gain or loss will be recognized by Eligible Account Holders,

Supplemental Eligible Account Holders or Other Members upon distribution to them of nontransferable subscription rights to purchase shares of New Waterstone common stock. Eligible Account Holders, Supplemental Eligible Account Holders and Other Members will not realize any taxable income as the result of the exercise by them of the nontransferable subscriptions rights.

14. It is more likely than not that the fair market value of the benefit provided by the liquidation account of WaterStone Bank supporting the payment of the New Waterstone liquidation account in the event New Waterstone lacks sufficient net assets is zero. Accordingly, it is more likely than not that no gain or loss will be recognized by Eligible Account Holders and Supplemental Eligible Account Holders upon the constructive distribution to them of such rights in the WaterStone Bank liquidation account as of the effective date of the merger of Waterstone-Federal with and into New Waterstone.
15. It is more likely than not that the basis of the shares of New Waterstone common stock purchased in the offering by the exercise of nontransferable subscription rights will be the purchase price. The holding period of the New Waterstone common stock purchased pursuant to the exercise of nontransferable subscription rights will commence on the date the right to acquire such stock was exercised.
16. No gain or loss will be recognized by New Waterstone on the receipt of money in exchange for New Waterstone common stock sold in the offering.

We believe that the tax opinions summarized above address all material federal income tax consequences that are generally applicable to Lamplighter Financial, MHC, Waterstone-Federal, WaterStone Bank, New Waterstone and persons receiving subscription rights and stockholders of Waterstone-Federal. With respect to items 13 and 15 above, Luse Gorman Pomerenk & Schick, P.C. noted that the subscription rights will be granted at no cost to the recipients, are legally non-transferable and of short duration, and will provide the recipient with the right only to purchase shares of common stock at the same price to be paid by members of the general public in any community offering. The firm further noted that RP Financial, LC. has issued a letter that the subscription rights have no ascertainable fair market value. The firm also noted that the Internal Revenue Service has not in the past concluded that subscription rights have value. Based on the foregoing, Luse Gorman Pomerenk & Schick, P.C. believes that it is more likely than not that the nontransferable subscription rights to purchase shares of common stock have no value. However, the issue of whether or not the nontransferable subscription rights have value is based on all the facts and circumstances. If the subscription rights granted to Eligible Account Holders, Supplemental Eligible Account Holders and Other Members are deemed to have an ascertainable value, receipt of these rights could result in taxable gain to those Eligible Account Holders, Supplemental Eligible Account Holders and Other Members who exercise the subscription rights in an amount equal to the ascertainable value, and we could recognize gain on a distribution. Eligible Account Holders, Supplemental Eligible Account Holders and Other Members are encouraged to consult with their own tax advisors as to the tax consequences in the event that subscription rights are deemed to have an ascertainable value.

The opinion as to item 14 above is based on the position that: (i) no holder of an interest in a liquidation account has ever received any payment attributable to a liquidation account; (ii) the interests in the liquidation accounts are not transferable; (iii) the amounts due under the liquidation account with respect to each Eligible Account Holder and Supplemental Eligible Account Holder will be reduced as their deposits in WaterStone Bank are reduced; and (iv) the WaterStone Bank liquidation account payment obligation arises only if New Waterstone lacks sufficient assets to fund the liquidation account.

In addition, we have received a letter from RP Financial, LC. stating its belief that the benefit provided by the WaterStone Bank liquidation account supporting the payment of the liquidation account in the event New Waterstone lacks sufficient net assets does not have any economic value at the time of the conversion. Based on the foregoing, Luse Gorman Pomerenk & Schick, P.C. believes it is more likely than not that such rights in the WaterStone Bank liquidation account have no value. If such rights are subsequently found to have an economic value, income may be recognized by each Eligible Account Holder or Supplemental Eligible Account Holder in the amount of such fair market value as of the date of the conversion.

The opinion of Luse Gorman Pomerenk & Schick, P.C., unlike a letter ruling issued by the Internal Revenue Service, is not binding on the Internal Revenue Service and the conclusions expressed therein may be challenged at a future date. The Internal Revenue Service has issued favorable rulings for transactions substantially similar to the proposed reorganization and stock offering, but any such ruling may not be cited as precedent by any

taxpayer other than the taxpayer to whom the ruling is addressed. We do not plan to apply for a letter ruling concerning the transactions described herein.

We have also received an opinion from Baker Tilly Virchow Krause, LLP that the Wisconsin state income tax consequences are consistent with the federal income tax consequences.

The federal and state tax opinions have been filed with the Securities and Exchange Commission as exhibits to New Waterstone's registration statement.

#### Certain Restrictions on Purchase or Transfer of Our Shares after Conversion

All shares of common stock purchased in the offering by a director or certain officers of WaterStone Bank generally may not be sold for a period of one year following the closing of the conversion, except in the event of the death of the director or officer. Each certificate for restricted shares will bear a legend giving notice of this restriction on transfer, and instructions will be issued to the effect that any transfer within this time period of any certificate or record ownership of the shares other than as provided above is a violation of the restriction. Any shares of common stock issued at a later date as a stock dividend, stock split, or otherwise, with respect to the restricted stock will be similarly restricted. The directors and executive officers of New Waterstone also will be restricted by the insider trading rules under the Securities Exchange Act of 1934.

Purchases of shares of our common stock by any of our directors, certain officers and their associates, during the three-year period following the closing of the conversion may be made only through a broker or dealer registered with the Securities and Exchange Commission, except with the prior written approval of the Federal Reserve Board. This restriction does not apply, however, to negotiated transactions involving more than 1% of our outstanding common stock or to purchases of our common stock by our stock option plan or any of our tax-qualified employee stock benefit plans or non-tax-qualified employee stock benefit plans, including any restricted stock plans.

Federal regulations prohibit New Waterstone from repurchasing its shares of common stock during the first year following conversion unless compelling business reasons exist for such repurchases, or to fund management recognition plans that have been ratified by stockholders (with Federal Reserve Board approval) or tax-qualified employee stock benefit plans. In addition, the repurchase of shares of common stock is subject to Federal Reserve Board policy related to repurchases of shares by financial institution holding companies.

#### PROPOSAL 2 — ADJOURNMENT OF THE SPECIAL MEETING

If there are not sufficient votes to constitute a quorum or to approve the plan of conversion at the time of the special meeting, the proposals may not be approved unless the special meeting is adjourned to a later date or dates in order to permit further solicitation of proxies. In order to allow proxies that have been received by Waterstone Financial, Inc. at the time of the special meeting to be voted for an adjournment, if necessary, Waterstone Financial, Inc. has submitted the question of adjournment to its stockholders as a separate matter for their consideration. The board of directors of Waterstone Financial, Inc. recommends that stockholders vote "FOR" the adjournment proposal. If it is necessary to adjourn the special meeting, no notice of the adjourned special meeting is required to be given to stockholders (unless the adjournment is for more than 30 days or if a new record date is fixed), other than an announcement at the special meeting of the hour, date and place to which the special meeting is adjourned.

The board of directors recommends that you vote "FOR" the adjournment of the special meeting, if necessary, to solicit additional proxies in the event that there are not sufficient votes at the time of the special meeting to approve the plan

of conversion.

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PROPOSALS 3 THROUGH 5 — INFORMATIONAL PROPOSALS RELATED TO THE  
ARTICLES OF INCORPORATION OF NEW WATERSTONE.

By their approval of the plan of conversion as set forth in Proposal 1, the board of directors of Waterstone Financial, Inc. has approved each of the informational proposals numbered 3 through 5, all of which relate to provisions included in the articles of incorporation of New Waterstone. Each of these informational proposals is discussed in more detail below.

As a result of the conversion, the public stockholders of Waterstone Financial, Inc., whose rights are presently governed by the charter and bylaws of Waterstone Financial, Inc., will become stockholders of New Waterstone, whose rights will be governed by the articles of incorporation and bylaws of New Waterstone. The following informational proposals address the material differences between the governing documents of the two companies. This discussion is qualified in its entirety by reference to the charter and bylaws of Waterstone Financial, Inc. and the articles of incorporation and bylaws of New Waterstone. See “Where You Can Find Additional Information” for procedures for obtaining a copy of those documents.

The provisions of New Waterstone’s articles of incorporation that are summarized as informational proposals 3 through 5 were approved as part of the process in which the board of directors of Waterstone Financial, Inc. approved the plan of conversion. These proposals are informational in nature only, because the Board of Governors of the Federal Reserve System’s regulations governing mutual-to-stock conversions do not provide for votes on matters other than the plan of conversion. Waterstone Financial, Inc.’s stockholders are not being asked to approve these informational proposals at the special meeting. While we are asking you to vote with respect to each of the informational proposals set forth below, the proposed provisions for which an informational vote is requested will become effective if stockholders approve the plan of conversion, regardless of whether stockholders vote to approve any or all of the informational proposals. The provisions of New Waterstone’s articles of incorporation and bylaws that are summarized as informational proposals may have the effect of deterring or rendering more difficult attempts by third parties to obtain control of New Waterstone, if such attempts are not approved by the board of directors, or may make the removal of the board of directors or management, or the appointment of new directors, more difficult.

Informational Proposal 3. – Approval of a Provision in New Waterstone’s Articles of Incorporation Requiring a Super-Majority Vote to Amend Certain Provisions of the Articles of Incorporation of New Waterstone. No amendment of the charter of Waterstone Financial, Inc. may be made unless it is first proposed by the board of directors, then preliminarily approved by the Board of Governors of the Federal Reserve System, and thereafter approved by the holders of a majority of the total votes eligible to be cast at a legal meeting. The articles of incorporation of New Waterstone generally may be amended by the holders of a majority of the shares entitled to vote; provided, however, that any amendment of Section C, D, E or F of Article Fifth (Preferred Stock, Restrictions on Voting Rights of the Corporation’s Equity Securities, Majority Vote and Quorum), Article 7 (Directors), Article 8 (Bylaws), Article 9 (Evaluation of Certain Offers), Article 10 (Indemnification, etc. of Directors and Officers), Article 11 (Limitation of Liability) and Article 12 (Amendment of the Articles of Incorporation) must be approved by the affirmative vote of the holders of at least 80% of the outstanding shares entitled to vote, except that the board of directors may amend the articles of incorporation without any action by the stockholders to increase or decrease the aggregate number of shares of capital stock.

These limitations on amendments to specified provisions of New Waterstone’s articles of incorporation are intended to ensure that the referenced provisions are not limited or changed upon a simple majority vote. While this limits the ability of stockholders to amend those provisions, Lamplighter Financial, MHC, as a 73.5% stockholder, currently can effectively block any stockholder proposed change to the charter.

The requirement of a super-majority stockholder vote to amend specified provisions of New Waterstone's articles of incorporation could have the effect of discouraging a tender offer or other takeover attempt where the ability to make fundamental changes through amendments to the articles of incorporation is an important element of the takeover strategy of the potential acquiror. The board of directors believes that the provisions limiting certain amendments to the articles of incorporation will put the board of directors in a stronger position to negotiate with

third parties with respect to transactions potentially affecting the corporate structure of New Waterstone and the fundamental rights of its stockholders, and to preserve the ability of all stockholders to have an effective voice in the outcome of such matters.

The board of directors recommends that you vote “FOR” the approval of a provision in New Waterstone’s articles of incorporation requiring a super-majority vote to approve certain amendments to New Waterstone’s articles of incorporation.

Informational Proposal 4. – Approval of a Provision in New Waterstone’s Articles of Incorporation Requiring a Super-Majority Vote of Stockholders to Approve Stockholder Proposed Amendments to New Waterstone’s Bylaws. An amendment to Waterstone Financial, Inc.’s bylaws proposed by stockholders must be approved by the holders of a majority of the total votes eligible to be cast at a legal meeting subject to applicable approval by the Board of Governors of the Federal Reserve System. The articles of incorporation of New Waterstone provides that stockholders may only amend the bylaws if such proposal is approved by the affirmative vote of the holders of at least 80% of the outstanding shares entitled to vote.

The requirement of a super-majority stockholder vote to amend the bylaws of New Waterstone is intended to ensure that the bylaws are not limited or changed upon a simple majority vote of stockholders. While this limits the ability of stockholders to amend the bylaws, Lamplighter Financial, MHC, as a 73.5% stockholder, currently can effectively block any stockholder proposed change to the bylaws. Also, the board of directors of both Waterstone Financial, Inc. and New Waterstone may by a majority vote amend either company’s bylaws.

This provision in New Waterstone’s articles of incorporation could have the effect of discouraging a tender offer or other takeover attempt where the ability to make fundamental changes through amendments to the bylaws is an important element of the takeover strategy of the potential acquiror. The board of directors believes that the provision limiting amendments to the bylaws will put the board of directors in a stronger position to negotiate with third parties with respect to transactions potentially affecting the corporate structure of New Waterstone and the fundamental rights of its stockholders, and to preserve the ability of all stockholders to have an effective voice in the outcome of such matters.

The board of directors recommends that you vote “FOR” the approval of the provision in New Waterstone’s articles of incorporation requiring a super-majority vote of stockholders to approve stockholder proposed amendments to New Waterstone’s bylaws.

Informational Proposal 5. – Approval of a Provision in New Waterstone’s Articles of Incorporation to Limit the Voting Rights of Shares Beneficially Owned in Excess of 10% of New Waterstone’s Outstanding Voting Stock. The articles of incorporation of New Waterstone provide that in no event shall any person, who directly or indirectly beneficially owns in excess of 10% of the then-outstanding shares of common stock as of the record date for the determination of shareholders entitled or permitted to vote on any matter, be entitled or permitted to vote in respect of the shares held in excess of the 10% limit. Beneficial ownership is determined pursuant to the federal securities laws and includes, but is not limited to, shares as to which any person and his or her affiliates (i) have the right to acquire pursuant to any agreement, arrangement or understanding or upon the exercise of conversion rights, exchange rights, warrants or options and (ii) have or share investment or voting power (but shall not be deemed the beneficial owner of any voting shares solely by reason of a revocable proxy granted for a particular meeting of shareholders, and that are not otherwise beneficially, or deemed by New Waterstone to be beneficially, owned by such person and his or her affiliates).

The foregoing restriction does not apply to any employee benefit plans of New Waterstone or any subsidiary or a trustee of a plan.

The provision in New Waterstone's articles of incorporation limiting the voting rights of beneficial owners of more than 10% of New Waterstone's outstanding voting stock is intended to limit the ability of any person to acquire a significant number of shares of New Waterstone common stock and thereby gain sufficient voting control so as to cause New Waterstone to effect a transaction that may not be in the best interests of New Waterstone and its

stockholders generally. This provision will not prevent a stockholder from seeking to acquire a controlling interest in New Waterstone, but it will prevent a stockholder from voting more than 10% of the outstanding shares of common stock unless that stockholder has first persuaded the board of directors of the merits of the course of action proposed by the stockholder. The board of directors of New Waterstone believes that fundamental transactions generally should be first considered and approved by the board of directors as it generally believes that it is in the best position to make an initial assessment of the merits of any such transactions and that its ability to make the initial assessment could be impeded if a single stockholder could acquire a sufficiently large voting interest so as to control a stockholder vote on any given proposal. This provision in New Waterstone's articles of incorporation makes an acquisition, merger or other similar corporate transaction less likely to occur, even if such transaction is supported by most stockholders, because it can prevent a holder of shares in excess of the 10% limit from voting the excess shares in favor of the transaction. Thus, it may be deemed to have an anti-takeover effect.

The board of directors recommends that you vote "FOR" the approval of a provision in New Waterstone's articles of incorporation to limit the voting rights of shares beneficially owned in excess of 10% of New Waterstone's outstanding voting stock.

## SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

The following tables set forth selected consolidated historical financial and other data of Waterstone-Federal and its subsidiaries for the periods and at the dates indicated. The following is only a summary and you should read it in conjunction with the business and financial information regarding Waterstone-Federal contained elsewhere in this proxy statement/prospectus, including the consolidated financial statements beginning on page F-1 of this proxy statement/prospectus. The information at December 31, 2012 and 2011, and for the years ended December 31, 2012, 2011, and 2010 is derived in part from the audited consolidated financial statements that appear in this proxy statement/prospectus. The information at December 31, 2010, 2009 and 2008 and for the years ended December 31, 2009 and 2008 is derived in part from audited consolidated financial statements that do not appear in this proxy statement/prospectus. The information at June 30, 2013 and for the six months ended June 30, 2013 and 2012, is unaudited and reflects only normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. The results of operations for the six months ended June 30, 2013 are not necessarily indicative of the results to be achieved for all of 2013 or for any other period.

	At December 31,					
	At June 30, 2013 (Unaudited) (In Thousands)	2012	2011	2010	2009	2008
<b>Selected Financial Condition Data:</b>						
Total assets	\$1,632,876	\$1,661,076	\$1,712,851	\$1,808,966	\$1,868,266	\$1,885,432
Securities available for sale	216,253	205,017	206,519	203,166	205,415	179,887
Federal Home Loan Bank stock	20,193	20,193	21,653	21,653	21,653	21,653
Loans receivable, net	1,079,148	1,102,629	1,184,234	1,277,262	1,391,516	1,534,591
Loans held for sale	132,045	133,613	88,283	96,133	45,052	12,993
Cash and cash equivalents	54,368	71,469	80,380	75,331	71,120	23,849
Deposits	893,007	939,513	1,051,292	1,145,529	1,164,890	1,195,897
Borrowings	490,046	479,888	461,138	456,959	507,900	487,000
Total shareholders' equity	209,345	202,634	166,372	172,220	168,592	171,267
Allowance for loan losses	27,767	31,043	32,430	29,175	28,494	25,167
Real estate owned	29,983	35,974	56,670	57,752	50,929	24,653

	For the Six Months Ended June 30, 2013 (Unaudited)		2012	For the Year Ended December 31, 2011 2010 2009 2008			
	(Unaudited)						
	(In Thousands, except per share amounts)						
<b>Selected Operating Data:</b>							
Interest income	\$32,084	\$35,931	\$69,846	\$79,352	\$89,933	\$98,488	\$104,078
Interest expense	12,017	14,876	27,901	32,836	40,269	54,577	63,027

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Net interest income	20,067	21,055	41,945	46,516	49,664	43,911	41,051
Provision for loan losses	2,960	5,100	8,300	22,077	25,832	26,687	37,629
Net income after provision for loan losses	17,107	15,955	33,645	24,439	23,832	17,224	3,422
Noninterest income	49,740	38,253	91,203	43,229	38,993	12,208	6,291
Noninterest expense	51,318	45,751	102,138	74,579	64,627	40,876	33,860
Income (loss) before income taxes	15,529	8,457	22,710	(6,911 )	(1,802 )	(11,444 )	(24,147 )
Provision for income taxes (benefit)	5,977	71	(12,204 )	562	52	(1,306 )	2,299
Net income (loss)	\$9,552	\$8,386	\$34,914	\$(7,473 )	\$(1,854 )	\$(10,138 )	\$(26,446 )
Income (loss) per share – basic	\$0.31	\$0.27	\$1.12	\$(0.24 )	\$(0.06 )	\$(0.33 )	\$(0.87 )
Income (loss) per share – diluted	\$0.30	\$0.27	\$1.12	\$(0.24 )	\$(0.06 )	\$(0.33 )	\$(0.87 )

	At or for the Six Months Ended June 30, (1)		At or for the Year Ended December 31, (Unaudited)					
	2013	2012	2012	2011	2010	2009	2008	
<b>Selected Financial Ratios and Other Data:</b>								
<b>Performance Ratios:</b>								
Return (loss) on average assets	1.18 %	0.99 %	2.07 %	(0.43 %)	(0.10 %)	(0.53 %)	(1.44 %)	
Return (loss) on average equity	9.28	9.61	18.89	(4.47 )	(1.09 )	(6.12 )	(13.76 )	
Interest rate spread (2)	2.43	2.46	2.45	2.67	2.67	2.21	1.99	
Net interest margin (3)	2.64	2.63	2.62	2.82	2.83	2.41	2.32	
Efficiency ratio (4)	73.51	77.14	76.71	83.12	72.90	72.84	71.52	
Average interest-earning assets to average interest-bearing liabilities	112.53	109.08	109.84	107.67	107.11	106.68	109.17	
<b>Capital Ratios:</b>								
Equity to total assets	12.82 %	10.46 %	12.20 %	9.71 %	9.52 %	9.02 %	9.08 %	
Average equity to average assets	12.71	10.32	10.94	9.55	9.18	8.67	10.44	
Total capital to risk-weighted assets (5)	18.87	15.11	17.34	14.58	14.13	13.74	12.84	
Tier 1 capital to risk-weighted assets (5)	17.61	13.84	16.07	13.31	12.87	12.48	11.58	
Tier 1 capital to average assets (5)	12.17	9.82	11.13	9.16	8.83	8.71	8.93	
<b>Asset Quality Ratios:</b>								
Allowance for loan losses as a percent of total loans	2.51 %	2.80 %	2.74 %	2.67 %	2.23 %	2.01 %	1.61 %	
Allowance for loan losses as a percent of non-performing loans	52.14	38.53	41.58	41.46	34.66	37.83	23.36	
Net charge-offs to average outstanding loans during the period	1.01	0.76	0.76	1.43	1.75	1.54	1.67	
Non-performing loans as a percent of total loans	4.81	7.26	6.59	6.43	6.44	5.30	6.91	
Non-performing assets as a percent of total assets	5.10	7.89	6.66	7.88	7.85	6.76	7.02	
<b>Other Data:</b>								
Number of full-service banking offices	8	8	8	8	8	8	8	
Number of full-time equivalent employees	782	607	726	574	595	518	320	

(1) Annualized where appropriate.

(2) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.

(3) Represents net interest income as a percent of average interest-earning assets.

(4) Represents non-interest expense divided by the sum of net interest income and non-interest income.

(5) Ratios are for WaterStone Bank only.





**RECENT DEVELOPMENTS**

The following tables set forth selected consolidated historical financial and other data of Waterstone-Federal and its subsidiaries for the periods and at the dates indicated. The following is only a summary and you should read it in conjunction with the business and financial information regarding Waterstone-Federal contained elsewhere in this proxy statement/prospectus, including the consolidated financial statements beginning on page F-1 of this proxy statement/prospectus. The information at December 31, 2012 is derived in part from the audited consolidated financial statements that appear in this proxy statement/prospectus. The information at September 30, 2013 and for the three and nine months ended September 30, 2013 and 2012 is unaudited and reflects only normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be achieved for all of 2013 or for any other period.

	At September 30, 2013 (Unaudited)	At December 31, 2012
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(In Thousands)

## Selected Financial Condition Data:

Total assets	\$ 1,597,818	\$ 1,661,076
Securities available for sale	211,629	205,017
Federal Home Loan Bank stock	20,193	20,193
Loans receivable, net	1,067,468	1,102,629
Loans held for sale	97,184	133,613
Cash and cash equivalents	77,907	71,469
Deposits	872,285	939,513
Borrowings	471,243	479,888
Total shareholders' equity	212,833	202,634
Allowance for loan losses	24,708	31,043
Real estate owned	23,147	35,974

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012

(Unaudited)

(In Thousands, except per share amounts)

## Selected Operating Data:

Interest income	\$ 15,533	\$ 17,274	\$ 47,617	\$ 53,205
Interest expense	5,955	6,639	17,972	21,515
Net interest income	9,578	10,635	29,645	31,690
Provision for loan losses	1,000	2,000	3,960	7,100

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Net income after provision for loan losses	8,578	8,635	25,685	24,590
Noninterest income	21,030	27,775	70,770	66,028
Noninterest expense	24,416	27,817	75,734	73,568
Income before income taxes	5,192	8,593	20,721	17,050
Provision for income taxes	1,973	145	7,950	216
Net income	\$ 3,219	\$ 8,448	\$ 12,771	\$ 16,834
Income per share – basic	\$ 0.10	\$ 0.27	\$ 0.41	\$ 0.54
Income per share – diluted	\$ 0.10	\$ 0.27	\$ 0.41	\$ 0.54

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	At or for the Three Months Ended September 30, 2013		At or for the Nine Months Ended September 30, 2012	
	2013	2012	2013	2012
	(Unaudited)			
<b>Selected Financial Ratios and Other Data (1):</b>				
<b>Performance Ratios:</b>				
Return on average assets	0.79 %	2.00 %	1.05 %	1.33 %
Return on average equity	6.04	18.26	8.20	12.25
Interest rate spread (2)	2.31	2.51	2.40	2.48
Net interest margin (3)	2.51	2.67	2.59	2.65
Efficiency ratio (4)	79.77	72.42	75.42	75.29
Average interest-earning assets to average interest-bearing liabilities	112.86	110.05	112.64	108.96
<b>Capital Ratios:</b>				
Equity to total assets	13.32 %	11.00 %	13.32 %	11.00 %
Average equity to average assets	13.12	10.95	12.81	10.82
Total capital to risk-weighted assets (5)	21.52	15.64	21.52	15.64
Tier 1 capital to risk-weighted assets (5)	20.26	14.37	20.26	14.37
Tier 1 capital to average assets (5)	12.68	10.50	12.68	10.50
<b>Asset Quality Ratios:</b>				
Allowance for loan losses as a percent of total loans	2.26 %	2.68 %	2.26 %	2.68 %
Allowance for loan losses as a percent of non-performing loans	43.03	42.06	43.03	42.06
Net charge-offs to average outstanding loans during the period	1.33	1.15	1.12	0.89
Non-performing loans as a percent of total loans	5.26	6.38	5.26	6.38
Non-performing assets as a percent of total assets	5.04	7.13	5.04	7.13
<b>Other Data:</b>				
Number of full-service banking offices	8	8	8	8
Number of full-time equivalent employees	860	710	860	710

(1) Annualized where appropriate.

(2) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.

(3) Represents net interest income as a percent of average interest-earning assets.

(4) Represents non-interest expense divided by the sum of net interest income and non-interest income.

(5) Ratios are for WaterStone Bank only.

Comparison of Financial Condition at September 30, 2013 and December 31, 2012

Total Assets. Total assets decreased by \$63.3 million, or 3.8%, to \$1.60 billion at September 30, 2013 from \$1.66 billion at December 31, 2012. The decrease in total assets reflects decreases in loans receivable of \$41.5 million, loans held for sale of \$36.4 million and real estate owned of \$12.8 million. These funds were used to reduce deposits by \$67.2 million, reduce short-term borrowings by \$8.6 million and increase available for sale securities by \$6.6 million during the nine months ended September 30, 2013.

Cash and Cash Equivalents. Cash and cash equivalents increased \$6.4 million, or 9.0%, to \$77.9 million at September 30, 2013, compared to \$71.5 million at December 31, 2012. The overall level of cash and cash equivalents continues to reflect our plan to maintain higher than usual liquidity given the current economic environment and relatively low rates of return available on securities and other investments.

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

	At September 30, 2013		At December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)			
Securities available for sale:				
Mortgage-backed securities	\$ 104,741	\$ 105,679	\$ 116,813	\$ 119,056
Collateralized mortgage obligations:				
Government-sponsored enterprise issued	20,381	20,639	29,207	29,579
Government-sponsored enterprise bonds	15,911	15,721	8,000	8,017
Municipal obligations	61,094	59,318	35,493	37,371
Other debt securities	5,000	5,102	5,000	5,070
Certificates of deposit	5,145	5,170	5,880	5,924
Total securities available for sale	\$ 212,272	\$ 211,629	\$ 200,393	\$ 205,017

Securities available for sale increased by \$6.6 million, or 3.2%, to \$211.6 million at September 30, 2013 from \$205.0 million at December 31, 2012. This increase reflects a \$21.9 million increase in municipal securities and a \$7.7 million increase in government-sponsored enterprise bonds, partially offset by a \$13.4 million decrease in mortgage-backed securities and an \$8.9 million decrease in government-sponsored enterprise issued collateralized mortgage obligations. During the nine months ended September 30, 2013, the proceeds from principal repayments on mortgage-related securities were reinvested in municipal securities that we considered to provide a better risk-adjusted return. As of September 30, 2013, we held two municipal securities with a total fair value of \$189,000 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 which was charged against earnings. There was no additional other than temporary impairment recorded during the nine months ended September 30, 2013.

Loans Held for Sale. Loans held for sale decreased \$36.4 million, or 27.3%, to \$97.2 million at September 30, 2013 from \$133.6 million at December 31, 2012. During the nine months ended September 30, 2013, \$1.42 billion in residential loans were originated for sale. During the same period, sales of loans held for sale totaled \$1.46 billion.

Loans Receivable. 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 September 30, 2013		At December 31, 2012	
	Amount	Percent	Amount	Percent
	(Dollars in Thousands)			
Mortgage loans:				
Residential real estate:				
One- to four-family	\$ 419,084	38.37 %	\$ 460,821	40.65 %
Multi-family	517,141	47.35	514,363	45.37
Home equity	35,218	3.22	36,494	3.22
Construction and land	30,903	2.83	33,818	2.98
Commercial real estate	70,234	6.43	65,495	5.78
Commercial loans	19,463	1.78	22,549	1.99
Consumer	133	0.01	132	0.01
Total loans	1,092,176	100.00 %	1,133,672	100.00 %
Allowance for loan losses	(24,708 )		(31,043 )	
Loans, net	\$ 1,067,468		\$ 1,102,629	

Loans receivable held for investment decreased \$41.5 million, or 3.7%, to \$1.09 billion at September 30, 2013 from \$1.13 billion at December 31, 2012. The decrease in total loans receivable was primarily attributable to a \$41.7 million decrease in one- to four-family loans, partially offset by a \$4.7 million increase in commercial real estate loans and a \$2.8 million increase in multi-family real estate loans. The decrease in one- to four-family loans reflects a decline in loan demand for adjustable-rate real estate mortgage loans as borrowers continue to prefer long-term fixed-rate loans that we do not generally retain in our portfolio. This resulted in a shift in the composition of loan originations during 2013 and 2012 from one- to four-family residential adjustable-rate loans to residential real estate loans collateralized by multi-family properties and commercial real estate, as these categories of borrowers displayed relatively stable levels of demand for our existing products. During the nine months ended September 30, 2013, \$10.1 million in loans were transferred to real estate owned and \$10.3 million were charged-off, net of recoveries.

Allowance for Loan Losses. The allowance for loan losses decreased \$6.3 million, or 20.4%, to \$24.7 million at September 30, 2013 from \$31.0 million at December 31, 2012. The \$6.3 million decrease in the allowance for loan losses during the nine months ended September 30, 2013 reflects improvement in both the quality of the loan portfolio as well as the overall local real estate market. We have experienced an improvement in a number of key loan quality metrics compared to December 31, 2012, 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 September 30, 2013, the allowance for loan losses to total loans receivable was 2.26% and was equal to 43.03% of non-performing loans, compared to 2.74% and 41.58%, respectively, at December 31, 2012. The overall \$6.3 million decrease in the allowance for loan losses during the nine months ended September 30, 2013 was primarily the result of a \$6.1 million decrease in the allowance for loan losses related to the one- to four-family category. The decrease related to this category resulted from the charge-off of specific reserves and improvement of key loan quality metrics, as well as a decrease in the overall balance of loans outstanding. While the

local real estate market has improved 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 85.4% of the total allowance for loan losses at September 30, 2013 and 89.1% at December 31, 2012.

Real Estate Owned. Total real estate owned decreased \$12.8 million, or 35.7%, to \$23.1 million at September 30, 2013 from \$36.0 million at December 31, 2012. During the nine months ended September 30, 2013,



\$10.1 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 \$1.1 million during the nine months ended September 30, 2013. During the same period, sales of real estate owned totaled \$22.0 million.

Deposits. Total deposits decreased \$67.2 million, or 7.2%, to \$872.3 million at September 30, 2013 from \$939.5 million at December 31, 2012. 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 \$80.4 million, or 10.9%, to \$656.5 million at September 30, 2013 from \$736.9 million at December 31, 2012. The decrease in time deposits was partially offset by an increase in money market and savings deposits and demand deposits. Total money market and savings deposits increased \$5.8 million, or 4.9%, to \$124.3 million at September 30, 2013 from \$118.5 million at December 31, 2012. Total demand deposits increased \$7.4 million, or 8.7%, to \$91.5 million at September 30, 2013 from \$84.1 million at December 31, 2012.

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

	At September 30, 2013			At December 31, 2012		
	Balance (Dollars in Thousands)	Percent	Weighted Average Rate	Balance	Percent	Weighted Average Rate
Deposit type:						
Demand deposits	\$45,739	5.24	% 0.00	% \$39,767	4.23	% 0.00
NOW accounts	45,650	5.23	0.03	% 44,373	4.72	0.03
Regular savings	59,999	6.88	0.05	% 54,837	5.84	0.10
Money market and savings deposits	64,361	7.38	0.11	% 63,616	6.77	0.15
Total transaction accounts	215,749	24.73	0.05	% 202,593	21.56	0.08
Certificates of deposit	656,536	75.27	0.70	% 736,920	78.44	0.83
Total deposits	\$872,285	100.00	% 0.54	% \$939,513	100.00	% 0.67

At September 30, 2013, the aggregate balance of certificates of deposit of \$100,000 or more was \$170.4 million. The following table sets forth the maturity of those certificates at September 30, 2013.

Due in:	At September 30, 2013 (In Thousands)
Three months or less	\$ 17,307
Over three months through six months	26,160
Over six months through 12 months	89,350
Over 12 months	37,603

Total \$ 170,420

**Borrowings.** Total borrowings decreased \$8.6 million, or 1.8%, to \$471.2 million at September 30, 2013 from \$479.9 million at December 31, 2012. The decrease in borrowings relates to a decrease in the use of short-term repurchase agreements to finance loans held for sale. The balance of these lines of credit decreased by \$8.6 to \$37.2 million at September 30, 2013, from \$45.9 million at December 31, 2012.

**Advance Payments by Borrowers for Taxes.** Advance payments by borrowers for taxes increased \$20.3 million to \$21.9 million at September 30, 2013 from \$1.7 million at December 31, 2012. The increase was the result of payments received from borrowers for their real estate taxes and is seasonally normal, as balances increase during the course of the calendar year until real estate tax obligations are paid out in the fourth quarter.

**Other Liabilities.** Other liabilities decreased \$17.8 million, or 47.8%, to \$19.5 million at September 30, 2013 from \$37.4 million at December 31, 2012. The decrease resulted primarily from a seasonal decrease in outstanding escrow checks. We receive payments from borrowers for their real estate taxes during the course of the

calendar year until real estate tax obligations are paid out in the fourth quarter. These amounts remain classified as other liabilities until settled. The decrease related to escrow checks was partially offset by an increase in amounts due to third parties related to the origination of loans held for sale.

Shareholders' Equity. Shareholders' equity increased by \$10.2 million, or 5.0%, to \$212.8 million at September 30, 2013 from \$202.6 million at December 31, 2012. The increase in shareholders' equity was primarily due to a \$12.8 million increase in retained earnings reflecting net income for the nine months ended September 30, 2013. In addition to the increase in retained earnings, shareholders' equity was positively impacted by a \$641,000 decrease in unearned ESOP shares. Partially offsetting the increases was a \$3.2 million decrease in accumulated other comprehensive income.

#### 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.

	Three Months Ended September 30,						
	2013			2012			
	Average Balance	Interest	Average Yield/Rate (7) (Dollars in Thousands)	Average Balance	Interest	Average Yield/Rate (7)	
<b>Interest-earning assets:</b>							
Loans receivable and held for sale	\$ 1,211,089	\$ 14,425 (1)	4.73 %	\$ 1,270,414	\$ 15,943 (1)	4.98	%
Mortgage related securities (2)	126,447	455	1.43	151,162	826	2.17	
Debt securities, federal funds sold and short-term investments (2) (3)	176,449	653	1.47	159,035	505	1.26	
Total interest-earning assets	1,513,985	15,533	4.07	1,580,611	17,274	4.34	
Noninterest-earning assets	96,925			96,074			
Total assets	\$ 1,610,910			\$ 1,676,685			
<b>Interest-bearing liabilities:</b>							
Demand accounts	\$ 46,771	4	0.03	\$ 42,888	6	0.06	
Money market and savings accounts	140,807	32	0.09	135,128	58	0.17	
Certificates of deposit	668,397	1,201	0.71	771,158	1,874	0.96	

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Total interest-bearing deposits	855,975	1,201	0.57	949,174	1,938	0.81
Borrowings	485,488	4,718	3.86	487,078	4,701	3.83
Total interest-bearing liabilities	1,341,463	5,955	1.76	1,436,252	6,639	1.83
Non-interest-bearing liabilities:						
Non-interest bearing deposits	44,795			35,446		
Other non-interest bearing liabilities	13,345			21,453		
Total non-interest bearing liabilities	58,140			56,899		
Total liabilities	1,399,603			1,493,151		
Equity	211,307			183,534		
Total liabilities and equity	\$ 1,610,910			\$ 1,676,685		
Net interest income		\$ 9,578			\$ 10,635	
Net interest rate spread (4)			2.31 %			2.51 %
Net interest-earning assets (5)	\$ 172,522			\$ 144,359		
Net interest margin (6)			2.51 %			2.67 %
Average interest-earning assets to average interest-bearing liabilities			112.86 %			110.05 %

(footnotes on following page)

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	Nine Months Ended September 30,					
	2013			2012		
	Average Balance	Interest	Average Yield/Rate (7) (Dollars in Thousands)	Average Balance	Interest	Average Yield/Rate (7)
<b>Interest-earning assets:</b>						
Loans receivable and held for sale	\$ 1,229,853	\$ 44,500 (1)	4.84 %	\$ 1,279,846	\$ 48,834 (1)	5.08 %
Mortgage related securities (2)	134,957	1,311	1.30	131,735	2,611	2.64
Debt securities, federal funds sold and short-term investments (2) (3)	163,492	1,806	1.48	184,072	1,760	1.27
Total interest-earning assets	1,528,302	47,617	4.17	1,595,653	53,205	4.44
Noninterest-earning assets	98,310			96,599		
Total assets	\$ 1,626,612			\$ 1,692,252		
<b>Interest-bearing liabilities:</b>						
Demand accounts	\$ 45,570	10	0.03	\$ 40,578	19	0.06
Money market and savings accounts	129,953	105	0.11	123,365	221	0.24
Certificates of deposit	695,960	3,940	0.76	828,235	7,564	1.22
Total interest-bearing deposits	871,483	4,055	0.62	992,178	7,804	1.05
Borrowings	485,316	13,917	3.83	472,317	13,711	3.87
Total interest-bearing liabilities	1,356,799	17,972	1.77	1,464,495	21,515	1.96
<b>Non-interest-bearing liabilities:</b>						
Non-interest bearing deposits	42,739			32,124		
Other non-interest bearing liabilities	18,786			12,571		
Total non-interest bearing liabilities	61,525			44,695		
Total liabilities	1,418,324			1,509,190		
Equity	208,288			183,062		
Total liabilities and equity	\$ 1,626,612			\$ 1,692,252		
Net interest income		\$ 29,645			\$ 31,690	
			2.40 %			2.48 %

Net interest rate spread				
(4)				
Net interest-earning assets (5)	\$ 171,503		\$ 131,158	
Net interest margin (6)		2.59 %		2.65 %
Average interest-earning assets to average interest-bearing liabilities		112.64 %		108.96 %

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(1) Includes net deferred loan fee amortization income of \$130,000, \$183,000, \$469,000 and \$478,000 for the three months ended September 30, 2013 and 2012 and the nine months ended September 30, 2013 and 2012, respectively.

(2) Average balance of available for sale securities is based on amortized historical cost.

(3) 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 \$49.6 million, \$15.4 million, \$45.8 million and \$18.9 million for the three months ended September 30, 2013 and 2012 and the nine months ended September 30, 2013 and 2012, respectively.

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

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

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

(7) Annualized.

## 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.

	Three Months Ended September 30, 2013 vs. 2012			Nine Months Ended September 30, 2013 vs. 2012		
	Increase (Decrease) due to			Increase (Decrease) due to		
	Volume	Rate	Net	Volume	Rate	Net
	(In Thousands)					
<b>Interest income:</b>						
Loans receivable and held for sale (1)	\$(726)	\$(792)	\$(1,518)	\$(1,939)	\$(2,395)	\$(4,334)
Mortgage related securities	(120)	(251)	(371)	62	(1,362)	(1,300)
Other interest-earning assets	59	89	148	(212)	258	46
Total interest-earning assets	(787)	(954)	(1,741)	(2,089)	(3,499)	(5,588)
<b>Interest expense:</b>						
Demand accounts	1	(3)	(2)	2	(11)	(9)
Money market and savings accounts	2	(29)	(27)	11	(128)	(117)
Certificates of deposit	(228)	(444)	(672)	(1,077)	(2,546)	(3,623)
Total interest-bearing deposits	(225)	(476)	(701)	(1,064)	(2,685)	(3,749)
Borrowings	(15)	32	17	336	(130)	206
Total interest-bearing liabilities	(240)	(444)	(684)	(728)	(2,815)	(3,543)
Net change in net interest income	\$(547)	\$(510)	\$(1,057)	\$(1,361)	\$(684)	\$(2,045)

(1) Includes net deferred loan fee amortization income of \$130,000, \$183,000, \$469,000 and \$478,000 for the three months ended September 30, 2013 and 2012 and the nine months ended September 30, 2013 and 2012, respectively.

## Segment Review

As described in the notes to consolidated financial statements, we have two reportable segments: community banking and mortgage banking. Community banking, which is conducted through WaterStone Bank, consists of lending and deposit taking (as well as other banking-related products and services) to consumers and businesses and the support to deliver, fund, and manage such banking services. Mortgage banking, which is conducted through Waterstone Mortgage Corporation, consists of originating residential mortgage loans for sale in the secondary market.

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The following tables set forth certain information with respect to our operating segments at and for the periods indicated.

	At and For the Three Months Ended September 30, 2013			
	Community	Mortgage	Holding	
	Banking	Banking	Company	Consolidated
			and	
			Other	
	(In Thousands)			
Net interest income	\$ 9,266	\$ 187	\$ 125	\$ 9,578
Provision for loan losses	1,000	—	—	1,000
Net income after provision for loan losses	8,266	187	125	8,578
Noninterest income	985	20,071	(26)	21,030
Noninterest expenses:				
Compensation, payroll taxes and other employee benefits	3,148	13,460	(33)	16,575
Occupancy, office furniture and equipment	775	1,458	(15)	2,218
FDIC insurance premiums	516	—	—	516
Real estate owned	(163)	—	—	(163)
Other	953	4,250	67	5,270
Total noninterest expenses	5,229	19,168	19	24,416
Income before income taxes	4,022	1,090	80	5,192
Income tax expense	1,478	451	44	1,973
Net income	\$ 2,544	\$ 639	\$ 36	\$ 3,219

	At and For the Three Months Ended September 30, 2012			
	Community	Mortgage	Holding	
	Banking	Banking	Company	Consolidated
			and	
			Other	
	(In Thousands)			
Net interest income	\$ 10,358	\$ 151	\$ 126	\$ 10,635
Provision for loan losses	2,000	—	—	2,000
Net income after provision for loan losses	8,358	151	126	8,635
Noninterest income	947	26,828	—	27,775
Noninterest expenses:				
Compensation, payroll taxes and other employee benefits	3,400	14,580	(157)	17,823
Occupancy, office furniture and equipment	826	994	—	1,820
FDIC insurance premiums	916	—	—	916
Real estate owned	1,991	—	—	1,991



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Other	1,033	4,166	68	5,267
Total noninterest expenses	8,166	19,740	(89)	27,817
Income before income taxes (benefit)	1,139	7,239	215	8,593
Income tax expense (benefit)	(2,846)	2,906	85	145
Net income	\$ 3,985	\$ 4,333	\$ 130	\$ 8,448

At and For the Nine Months Ended September 30, 2013

	Community Banking	Mortgage Banking (In Thousands)	Holding Company and Other	Consolidated
Net interest income	\$ 28,925	\$ 346	\$ 374	\$ 29,645
Provision for loan losses	3,900	60	—	3,960
Net income after provision for loan losses	25,025	286	374	25,685
Noninterest income	2,435	68,451	(116)	70,770
Noninterest expenses:				
Compensation, payroll taxes and other employee benefits	10,015	43,165	(179)	53,001
Occupancy, office furniture and equipment	2,372	3,704	(81)	5,995
FDIC insurance premiums	1,569	—	—	1,569
Real estate owned	(9)	—	—	(9)
Other	3,020	11,962	196	15,178
Total noninterest expenses	16,967	58,831	(64)	75,734
Income before income taxes	10,493	9,906	322	20,721
Income tax expense	3,839	3,992	119	7,950
Net income	\$ 6,654	\$ 5,914	\$ 203	\$ 12,771

At and For the Nine Months Ended September 30, 2012

	Community Banking	Mortgage Banking (In Thousands)	Holding Company and Other	Consolidated
Net interest income	\$ 30,940	\$ 374	\$ 376	\$ 31,690
Provision for loan losses	7,100	—	—	7,100
Net income after provision for loan losses	23,840	374	376	24,590
Noninterest income	2,391	63,637	—	66,028
Noninterest expenses:				
Compensation, payroll taxes and other employee benefits	9,613	34,359	(547)	43,425
Occupancy, office furniture and equipment	2,374	2,855	—	5,229
FDIC insurance premiums	2,730	—	—	2,730
Real estate owned	6,265	—	—	6,265
Other	3,572	12,125	222	15,919
Total noninterest expenses	24,554	49,339	(325)	73,568
	1,677	14,672	701	17,050

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Income before income taxes (benefit)					
Income tax expense (benefit)	(5,953)	5,898	250	216	
Net income	\$ 7,630	\$ 8,783	\$ 421	\$ 16,834	

Our community banking segment generates the significant majority of our consolidated net interest income and requires the significant majority of our provision for loan losses. Our mortgage banking segment generates the significant majority of our non-interest income and a majority of our non-interest expense. Accordingly, we have provided below a discussion of the material results of operations of Waterstone Mortgage Corporation on a separate basis for the three and nine months ended September 30, 2013 and 2012, which focuses on a discussion of non-interest income and non-interest expense. We have also provided a discussion of the consolidated operations of Waterstone-Federal, which includes the consolidated operations of WaterStone Bank and Waterstone Mortgage Corporation, for the same periods.

### Comparison of Mortgage Banking Segment Operations for the Three Months Ended September 30, 2013 and 2012

Mortgage banking revenues decreased \$6.8 million, or 25.2%, to \$20.1 million for the three months ended September 30, 2013 compared to \$26.8 million during the three months ended September 30, 2012. The \$6.8 million decrease in mortgage banking revenues was attributable to a decrease in loan origination volume. Loans originated for sale in the secondary market totaled \$441.5 million during the three months ended September 30, 2013, which represents a \$36.4 million, or 7.6%, decrease in originations from the three months ended September 30, 2012, which totaled \$477.9 million. The decrease in loan origination volumes primarily reflected a decrease in demand for refinanced loans due in large part to an increase in interest rates on these products beginning in the spring of 2013. In addition to the decrease in loan originations, mortgage banking revenues decreased due to a significant decline in margin. Weighted average margin dropped by 146 basis points to 3.32% of origination volume during the three months ended September 30, 2013 compared to 4.78% during the three months ended September 30, 2012. The decrease in average sales margin reflects a decrease in pricing and fees on all products in all geographic markets.

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 three months ended September 30, 2013, originations shifted towards governmental loans and loans made to purchase real estate. Loans originated for the purchase of a residential property comprised 79.5% of total originations during the three months ended September 30, 2013, compared to 54.8% during the three months ended September 30, 2012. The mix of loan type also changed slightly, with conventional loans and governmental loans comprising 61.0% and 39.0% of all loan originations, respectively, during the three months ended September 30, 2013. During the three months ended September 30, 2012, conventional loans and governmental loans comprised 69.4% and 30.6% of all loan originations, respectively.

Due primarily to a decrease in loan origination activity, total compensation, payroll taxes and other benefits at our mortgage banking subsidiary decreased \$1.1 million, or 7.7%, to \$13.5 million for the three months ended September 30, 2013 compared to \$14.6 million during the three months ended September 30, 2012. The decrease in compensation at our mortgage banking subsidiary reflects the decrease in mortgage banking income and the commission-based compensation structure in place for our mortgage banking loan officers. However, reduced commission expense was partially offset by an increase in salary expense due to increased staffing needed to support accumulated transaction growth.

### Comparison of Operating Results for the Three Months Ended September 30, 2013 and 2012

General. Net income for the three months ended September 30, 2013 totaled \$3.2 million, or \$0.10 for both basic and diluted income per share, compared to net income of \$8.4 million, or \$0.27 for both basic and diluted income per share, for the three months ended September 30, 2012. The three months ended September 30, 2013 generated an annualized return on average assets of 0.79% and an annualized return on average equity of 6.04%, compared to an annualized return on average assets of 2.00% and an annualized return on average equity of 18.26% for the comparable period in 2012. Income before income taxes decreased \$3.4 million to \$5.2 million during the three months ended September 30, 2013, compared to \$8.6 million during the three months ended September 30, 2012. The pre-tax results of operations for the three months ended September 30, 2013 as compared to the three months ended September 30, 2012 reflect a \$6.1 million decrease in pre-tax income from the mortgage banking segment and a \$2.9 million increase in pre-tax income from the community banking segment. Income taxes totaled \$2.0 million during the three months ended September 30, 2013, compared to \$145,000 during the three months ended September 30, 2012.

**Total Interest Income.** Total interest income decreased \$1.7 million, or 10.1%, to \$15.5 million during the three months ended September 30, 2013 from \$17.3 million during the three months ended September 30, 2012.

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Interest income on loans decreased \$1.5 million, or 9.5%, to \$14.4 million during the three months ended September 30, 2013 from \$15.9 million during the three months ended September 30, 2012. The decrease in interest income was primarily due to a 25 basis point decrease in the average yield on loans to 4.73% for the three months ended September 30, 2013 from 4.98% for the three months ended September 30, 2012. The decrease in interest income on loans also reflects a \$59.3 million, or 4.7%, decrease in the average balance of loans outstanding to \$1.21 billion during the three months ended September 30, 2013 from \$1.27 billion during the three months ended September 30, 2012.

Interest income from mortgage-related securities decreased \$371,000, or 44.9%, to \$455,000 during the three months ended September 30, 2013 from \$826,000 during the three months ended September 30, 2012. The decrease in interest income was due to a 74 basis point decrease in the average yield on mortgage-related securities to 1.43% for the three months ended September 30, 2013 from 2.17% for the three months ended September 30, 2012. The decrease in interest income on mortgage-related securities also reflects a \$24.7 million, or 16.4%, decrease in the average balance of mortgage-related securities to \$126.4 million for the three months ended September 30, 2013 from \$151.2 million during the three months ended September 30, 2012. The decrease in average yield resulted from a general turnover of the investment security portfolio in which cash flow from higher yielding securities was reinvested in securities at lower yields due to the low interest rate environment.

Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) increased \$148,000, or 29.3%, to \$653,000 for the three months ended September 30, 2013 compared to \$505,000 for the three months ended September 30, 2012. Interest income on other interest earning assets increased due to a 21 basis point increase in the average yield on other interest earning assets to 1.47% for the three months ended September 30, 2013 from 1.26% for the three months ended September 30, 2012. The average balance of higher yielding, tax-exempt municipal securities increased to \$49.6 million for the three months ended September 30, 2013 from \$15.4 million for the three months ended September 30, 2012, accounting for the increase in the average yield for the period. The increase in interest income on other interest earning assets also reflects an increase of \$17.4 million, or 11.0%, in the average balance of other earning assets to \$176.4 million during the three months ended September 30, 2013 from \$159.0 million during the three months ended September 30, 2012.

**Total Interest Expense.** Total interest expense decreased by \$684,000, or 10.3%, to \$6.0 million during the three months ended September 30, 2013 from \$6.6 million during the three months ended September 30, 2012. 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 7 basis points to 1.76% for the three months ended September 30, 2013 from 1.83% for the three months ended September 30, 2012. Total average interest bearing deposits and borrowings outstanding decreased \$94.8 million, or 6.6%, to \$1.34 billion for the three months ended September 30, 2013 compared to an average balance of \$1.44 billion for the three months ended September 30, 2012.

Interest expense on deposits decreased \$701,000, or 36.2%, to \$1.2 million during the three months ended September 30, 2013 from \$1.9 million during the three months ended September 30, 2012. The decrease in interest expense on deposits was primarily due to a decrease in the average cost of deposits of 24 basis points to 0.57% for the three months ended September 30, 2013 compared to 0.81% for the three months ended September 30, 2012. The decrease in the cost of deposits reflects the current 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 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 \$93.2 million, or 9.8%, in the average balance of interest

bearing deposits to \$856.0 million during the three months ended September 30, 2013 from \$949.2 million during the three months ended September 30, 2012. 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 the Bank's liquidity needs and funding obligations.

Interest expense on borrowings was unchanged at \$4.7 million during the three months ended September 30, 2013 and three months ended September 30, 2012. The average cost of borrowings increased by 3 basis points

to 3.86% for the three months ended September 30, 2013 compared to 3.83% for the three months ended September 30, 2012. The increase in the cost of borrowings was offset by a \$1.6 million, or 0.3%, decrease in average borrowings outstanding to \$485.5 million during the three months ended September 30, 2013 from \$487.1 million during the three months ended September 30, 2012. The decreased use of borrowings as a funding source during the three months ended September 30, 2013 reflects a decreased use of short-term repurchase agreements by our mortgage banking segment to fund loan originations to be sold in the secondary market.

**Net Interest Income.** Net interest income decreased by \$1.1 million, or 9.9%, to \$9.6 million during the three months ended September 30, 2013 as compared to \$10.6 million during the three months ended September 30, 2012. The decrease in net interest income resulted from a 20 basis point decrease in our net interest rate spread to 2.31% during the three months ended September 30, 2013 from 2.51% during the three months ended September 30, 2012. The 20 basis point decrease in the net interest rate spread resulted from a 27 basis point decrease in the average yield on interest earning assets, which was partially offset by a 7 basis point decrease in the average cost of interest bearing liabilities.

**Provision for Loan Losses.** Our provision for loan losses decreased \$1.0 million, or 50.0%, to \$1.0 million during the three months ended September 30, 2013, from \$2.0 million during the three months ended September 30, 2012. 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 rates. While the provision for loan losses has decreased from the prior year, it remains at historically elevated levels. These levels remain elevated 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. See the “Asset Quality” section for an analysis of nonperforming assets, delinquent loans and troubled debt restructurings.

**Noninterest Income.** Total noninterest income decreased \$6.7 million, or 24.3%, to \$21.0 million during the three months ended September 30, 2013 from \$27.8 million during the three months ended September 30, 2012. The decrease resulted primarily from a decrease in mortgage banking income. See “Comparison of Mortgage Banking Segment Operations for the Three Months Ended September 30, 2013 and 2012” above for a discussion of the decrease in mortgage banking income.

Total other noninterest income increased \$1.7 million to \$2.0 million during the three months ended September 30, 2013 from \$302,000 during the three months ended September 30, 2012. The increase resulted primarily from a \$1.3 million gain on sale of mortgage servicing rights during the current period with no comparable transactions during 2012.

**Noninterest Expense.** Total noninterest expense decreased \$3.4 million, or 12.2%, to \$24.4 million during the three months ended September 30, 2013 from \$27.8 million during the three months September 30, 2012. The decrease was primarily attributable to decreased compensation and real estate owned expense.

Compensation, payroll taxes and other employee benefit expense decreased \$1.2 million, or 7.0%, to \$16.6 million during the three months ended September 30, 2013 compared to \$17.8 million during the three months ended September 30, 2012. Due primarily to an decrease in loan origination activity, total compensation, payroll taxes and other benefits at our mortgage banking subsidiary decreased \$1.1 million, or 7.7%, to \$13.5 million for the three months ended September 30, 2013 compared to \$14.6 million during the three months ended September 30,



2012. The decrease in compensation at our mortgage banking subsidiary reflects the decrease in mortgage banking income and the commission-based compensation structure in place for our mortgage banking loan officers. However, reduced commission expense was partially offset by an increase in salary expense due to increased staffing needed to support accumulated transaction growth.

Real estate owned management and sales activity generated \$163,000 of income during the three months ended September 30, 2013 compared to \$2.0 million of expense during the three months ended September 30, 2012. Real estate owned income or 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 real estate acquired through foreclosure, 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 recognized upon the sale of properties. During the three months ended September 30, 2013, net operating expense, which primarily relates to property taxes, maintenance and management fees, net of rental income, decreased \$60,000, or 14.7%, to \$348,000 from \$408,000 during the three months ended September 30, 2012. 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 average balance of properties owned. The average balance of real estate owned totaled \$26.8 million for the three months ended September 30, 2013 compared to \$48.8 million for the three months ended September 30, 2012. Sales and write-downs of real estate owned resulted in a net gain of \$512,000 during the three months ended September 30, 2013. During the three months ended September 30, 2012, sales and write downs of real estate owned resulted in a net loss of \$1.6 million.

**Income Taxes.** Income tax expense increased from \$145,000 during the three months ended September 30, 2012 to \$2.0 million for the three months ended September 30, 2013. During the third quarter of 2008, we established a valuation allowance against our net deferred tax assets. That valuation allowance effectively resulted in no income tax expense being recognized during the three months ended September 30, 2012 other than state income taxes for states in which separate company returns are filed. During the fourth quarter of 2012, we released the valuation allowance against our net deferred tax assets. Therefore, income tax expense is recognized during the three months ended September 30, 2013 at an effective rate of 38.0% of pretax book income.

As of September 30, 2013, net deferred tax assets totaled \$14.3 million, which, in the judgment of management, will more-likely-than-not be fully realized. The largest components of the deferred tax assets are associated with the allowance for loan losses and basis adjustments on real estate owned. We are largely relying on earnings generated in the current year and forecasted earnings in future years in making the determination that we will more-likely-than-not realize our deferred tax assets.

#### Comparison of Mortgage Banking Segment Operations for the Nine Months Ended September 30, 2013 and 2012

Mortgage banking revenues increased \$4.8 million, or 7.6%, to \$68.5 million for the nine months ended September 30, 2013 compared to \$63.6 million during the nine months ended September 30, 2012. The \$4.8 million increase in mortgage banking revenues was attributable to an increase in loan origination volume. Loans originated for sale in the secondary market totaled \$1.42 billion during the nine months ended September 30, 2013, which represents a \$174.8 million, or 14.0%, increase in originations from the nine months ended September 30, 2012, which totaled \$1.25 billion. Loans originated for sale increased during the 2013 period despite the decrease in loans originated for sale during the three months ended September 30, 2013, as described above. The increase in mortgage banking income attributable to an increase in loan origination and sales volume was partially offset by a decrease in margins. Weighted average margins decreased by 115 basis points to 3.41% of loan originations during the nine months ended September 30, 2013 compared to 4.56% during the nine months ended September 30, 2012. The decrease in average sales margin reflects a decrease in pricing and fees on all products in all geographic markets.

During the nine months ended September 30, 2013, originations shifted towards governmental loans and loans made for the purpose of purchasing a home. Loans originated for the purchase of a residential property comprised 64.6% of total originations during the nine months ended September 30, 2013, compared to 58.0% during the nine months ended September 30, 2012. The mix of loan type also changed slightly with conventional loans and governmental loans comprising 62.7% and 37.3% of all loan originations, respectively, during the nine months ended September 30, 2013. During the nine months ended September 30, 2012 conventional loans and governmental loans comprised

66.6% and 33.4% of all loan originations, respectively.

Due primarily to an increase in loan origination activity, total compensation, payroll taxes and other benefits at our mortgage banking subsidiary increased \$8.8 million, or 25.6%, to \$43.2 million for the nine months ended September 30, 2013 compared to \$34.4 million during the nine months ended September 30, 2012. The increase in compensation at our mortgage banking subsidiary reflects the increase in mortgage banking income and

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the commission-based compensation structure in place for our mortgage banking loan officers, and was also due to an increase in salary expense related to increased staffing needed to support accumulated transaction growth.

#### Comparison of Operating Results for the Nine Months Ended September 30, 2013 and 2012

General. Net income for the nine months ended September 30, 2013 totaled \$12.8 million, or \$0.41 for both basic and diluted income per share, compared to net income of \$16.8 million, or \$0.54 for both basic and diluted income per share, for the nine months ended September 30, 2012. The nine months ended September 30, 2013 generated an annualized return on average assets of 1.05% and an annualized return on average equity of 8.20%, compared to an annualized return on average assets of 1.33% and an annualized return on average equity of 12.25% for the comparable period in 2012. Income before income taxes increased \$3.7 million to \$20.7 million during the nine months ended September 30, 2013, compared to \$17.0 million during the nine months ended September 30, 2012. The pre-tax results of operations for the nine months ended September 30, 2013 as compared to the nine months ended September 30, 2012 reflect an \$8.8 million increase in pre-tax income from the community banking segment, including a \$2.0 million decrease in net interest income, a \$6.3 million decrease in real estate owned expense, a \$3.1 million decrease in the provision for loan losses and a \$1.2 million decrease in Federal Deposit Insurance Corporation insurance expense, partially offset by \$4.8 million decrease in pre-tax income from our mortgage banking operations. Income taxes totaled \$8.0 million during the nine months ended September 30, 2013, compared to \$216,000 during the nine months ended September 30, 2012.

Total Interest Income. Total interest income decreased \$5.6 million, or 10.5%, to \$47.6 million during the nine months ended September 30, 2013 from \$53.2 million during the nine months ended September 30, 2012.

Interest income on loans decreased \$4.3 million, or 8.9%, to \$44.5 million during the nine months ended September 30, 2013 from \$48.8 million during the nine months ended September 30, 2012. The decrease in interest income was primarily due to a 24 basis point decrease in the average yield on loans to 4.84% for the nine months ended September 30, 2013 from 5.08% for the nine months ended September 30, 2012. The decrease in interest income on loans also reflects a \$50.0 million, or 3.9%, decrease in the average balance of loans outstanding to \$1.23 billion during the nine months ended September 30, 2013 from \$1.28 billion during the nine months ended September 30, 2012.

Interest income from mortgage-related securities decreased \$1.3 million, or 49.8%, to \$1.3 million during the nine months ended September 30, 2013 from \$2.6 million during the nine months ended September 30, 2012. The decrease in interest income was due to a 134 basis point decrease in the average yield on mortgage-related securities to 1.30% for the nine months ended September 30, 2013 from 2.64% for the nine months ended September 30, 2012. The decrease in average yield was partially offset by a \$3.2 million, or 2.4%, increase in the average balance of mortgage-related securities to \$135.0 million for the nine months ended September 30, 2013 from \$131.7 million during the nine months ended September 30, 2012. The decrease in average yield resulted from a general turnover of the investment security portfolio in which cash flows from higher yielding securities were reinvested in lower yielding securities due to the low interest rate environment.

Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) increased \$46,000, or 2.6%, to \$1.8 million for the nine months ended September 30, 2013 compared to \$1.8 million for the nine months ended September 30, 2012. Interest income increased due to a 21 basis point increase in the average yield on other earning assets to 1.48% for the nine months ended September 30, 2013 from 1.27% for the nine months ended September 30, 2012. The average balance of higher yielding, tax-exempt municipal securities increased to \$45.8 million for the nine months ended September 30, 2013 from \$18.9 million for the nine months ended September 30, 2012, accounting for the increase in the average yield for the period. The increase in

interest income from other earning assets due to an increase in average yield was partially offset by a decrease of \$20.6 million, or 11.2%, in the average balance of other earning assets to \$163.5 million during the nine months ended September 30, 2013 from \$184.1 million during the nine months ended September 30, 2012.

Total Interest Expense. Total interest expense decreased by \$3.5 million, or 16.5%, to \$18.0 million during the nine months ended September 30, 2013 from \$21.5 million during the nine months ended September 30,

2012. 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 19 basis points to 1.77% for the nine months ended September 30, 2013 from 1.96% for the nine months ended September 30, 2012. Total average interest bearing deposits and borrowings outstanding decreased \$107.7 million, or 7.4%, to \$1.36 billion for the nine months ended September 30, 2013 compared to an average balance of \$1.46 billion for the nine months ended September 30, 2012.

Interest expense on deposits decreased \$3.7 million, or 48.0%, to \$4.1 million during the nine months ended September 30, 2013 from \$7.8 million during the nine months ended September 30, 2012. The decrease in interest expense on deposits was primarily due to a decrease in the average cost of deposits of 43 basis points to 0.62% for the nine months ended September 30, 2013 compared to 1.05% for the nine months ended September 30, 2012. The decrease in the cost of deposits reflects the current 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 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 \$120.7 million, or 12.2%, in the average balance of interest bearing deposits to \$871.5 million during the nine months ended September 30, 2013 from \$992.2 million during the nine months ended September 30, 2012. 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 the Bank's liquidity needs and funding obligations.

Interest expense on borrowings increased \$206,000, or 1.5%, to \$13.9 million during the nine months ended September 30, 2013 from \$13.7 million during the nine months ended September 30, 2012. The increase primarily resulted from a \$13.0 million, or 2.8%, increase in average borrowings outstanding to \$485.3 million during the nine months ended September 30, 2013 from \$472.3 million during the nine months ended September 30, 2012. The increased use of borrowings as a funding source during the nine months ended September 30, 2013 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 increase in average balance was partially offset by a 4 basis point decrease in the average cost of borrowings to 3.83% during the nine months ended September 30, 2013 compared to 3.87% during the nine months ended September 30, 2012.

Net Interest Income. Net interest income decreased by \$2.0 million, or 6.5%, to \$29.6 million during the nine months ended September 30, 2013 as compared to \$31.7 million during the nine months ended September 30, 2012. The decrease in net interest income resulted primarily from an 8 basis point decrease in our net interest rate spread to 2.40% during the nine months ended September 30, 2013 from 2.48% during the nine months ended September 30, 2012. The 8 basis point decrease in the net interest rate spread resulted from a 27 basis point decrease in the average yield on interest earning assets, which was partially offset by a 19 basis point decrease in the average cost of interest bearing liabilities.

Provision for Loan Losses. Our provision for loan losses decreased \$3.1 million, or 44.2%, to \$4.0 million during the nine months ended September 30, 2013, from \$7.1 million during the nine months ended September 30, 2012. 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 rates. While the provision for loan losses has decreased from the prior year, it remains at historically elevated levels. These levels remain elevated 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. See the “Asset Quality” section for an analysis of nonperforming assets, delinquent loans and troubled debt restructurings.

Noninterest Income. Total noninterest income increased \$4.7 million, or 7.2%, to \$70.8 million during the nine months ended September 30, 2013 from \$66.0 million during the nine months ended September 30, 2012. The increase resulted primarily from an increase in mortgage banking income and a gain on sale of mortgage servicing rights. Mortgage banking income increased \$2.2 million to \$65.6 million for the nine months ended September 30,

2013 compared to \$63.4 million for the nine months ended September 30, 2012. See “Comparison of Mortgage Banking Segment Operations for the Nine Months Ended September 30, 2013 and 2012” above for a discussion of the increase in mortgage banking income. Total other noninterest income increased \$2.5 million to \$3.2 million during the nine months ended September 30, 2013 from \$671,000 during the nine months ended September 30, 2012. The increase resulted primarily from a \$1.3 million gain on sale of mortgage servicing rights during the current period. There were no comparable transactions in 2012.

**Noninterest Expense.** Total noninterest expense increased \$2.2 million, or 2.9%, to \$75.7 million during the nine months ended September 30, 2013 from \$73.6 million during the nine months September 30, 2012. The increase was primarily attributable to increased compensation, partially offset by a decrease in real estate owned expense.

Compensation, payroll taxes and other employee benefit expense increased \$9.6 million, or 22.1%, to \$53.0 million during the nine months ended September 30, 2013 compared to \$43.4 million during the nine months ended September 30, 2012. Due primarily to an increase in loan origination activity, total compensation, payroll taxes and other benefits at our mortgage banking subsidiary increased \$8.8 million, or 25.6%, to \$43.2 million for the nine months ended September 30, 2013 compared to \$34.4 million during the nine months ended September 30, 2012. The increase in compensation at our mortgage banking subsidiary reflects the increase in mortgage banking income and the commission-based compensation structure in place for our mortgage banking loan officers, and was also due to an increase in salary expense related to increased staffing needed to support accumulated transaction growth.

Real estate owned management and sales activity generated \$9,000 of income during the nine months ended September 30, 2013 compared to \$6.3 million of expense during the nine months ended September 30, 2012. 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 a 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 recognized upon the sale of properties. During the nine months ended September 30, 2013, net operating expense, which primarily relates to property taxes, maintenance and management fees, net of rental income, decreased \$708,000, or 35.2%, to \$1.3 million, from \$2.0 million during the nine months ended September 30, 2012. 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 average balance of properties owned. The average balance of real estate owned totaled \$30.6 million for the nine months ended September 30, 2013 compared to \$52.8 million for the nine months ended September 30, 2012. Sales and write-downs of real estate owned resulted in a net gain of \$1.3 million during the nine months ended September 30, 2013. During the nine months ended September 30, 2012, sales and write downs of real estate owned resulted in a net loss of \$4.3 million.

**Income Taxes.** Income tax expense increased from \$216,000 during the nine months ended September 30, 2012 to \$8.0 million for the nine months ended September 30, 2013. This increase was partially due to the increase in our income before income taxes, which increased from \$17.0 million during the nine months ended September 30, 2012 to \$20.7 million during the nine months ended September 30, 2013. In addition, during the third quarter of 2008, we established a valuation allowance against our net deferred tax assets. That valuation allowance effectively resulted in no income tax expense being recognized during the nine months ended September 30, 2012 other than state income taxes for states in which separate company returns are filed. During the fourth quarter of 2012, we released the valuation allowance against our net deferred tax assets. Therefore, income tax expense is recognized during the nine months ended September 30, 2013 at an effective rate of 38.4% of pretax book income.



As of September 30, 2013, net deferred tax assets totaled \$14.3 million, which, in the judgment of management, will more-likely-than-not be fully realized. The largest components of the deferred tax assets are associated with the allowance for loan losses and basis adjustments on real estate owned. We are largely relying on earnings generated in the current year and forecasted earnings in future years in making the determination that we will more-likely-than-not realize our deferred tax assets.

## Management of Market Risk

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 simulations use projected repricing of assets and liabilities at September 30, 2013 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 in Estimated Net Annual Interest Income Over 12 Months As of September 30, 2013
300 basis point gradual rise in rates	5.63%
200 basis point gradual rise in rates	5.81%
100 basis point gradual rise in rates	6.09%
Unchanged rate scenario	6.18%
100 basis point gradual decline in rates (1)	6.02%

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

## Loan Originations, Purchases and Other Activity

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

	As of or for the Nine Months Ended September 30,	
	2013	2012
	(In Thousands)	
Total gross loans receivable and held for sale at beginning of period	\$ 1,267,285	\$ 1,304,947
Real estate loans originated for investment:		
Residential:		
One- to four-family	14,195	14,705
Multi-family	56,809	36,144
Home equity	6,586	2,115
Construction and land	10,510	2,056
Commercial real estate	5,239	12,860
Total real estate loans originated for investment	93,339	67,880
Consumer loans originated for investment	12	35
Commercial loans originated for investment	5,135	3,801
Total loans originated for investment	98,486	71,716
Total real estate loans purchased for investment	—	15,486
Principal repayments	(119,570 )	(121,282 )
Transfers to real estate owned	(10,117 )	(19,729 )
Loan principal charged-off, net of recoveries	(10,295 )	(8,563 )
Net activity in loans held for investment	(41,496 )	62,372
Loans originated for sale	1,419,834	1,245,018
Loans sold	(1,456,263)	(1,210,144)
Net activity in loans held for sale	(36,429 )	34,874
Total gross loans receivable and held for sale at end of period	\$ 1,189,360	\$ 1,277,449

## Asset Quality

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

	At September 30, 2013	At December 31, 2012		
	(Dollars in Thousands)			
Non-accrual loans:				
Residential				
One- to four-family	\$ 36,704	\$ 46,467		
Multi-family	13,633	23,205		
Home equity	1,345	1,578		
Construction and land	4,237	2,215		
Commercial real estate	974	668		
Commercial	510	511		
Consumer	19	24		
Total non-accrual loans	57,422	74,668		
Real estate owned				
One- to four-family	12,478	17,353		
Multi-family	4,192	9,890		
Construction and land	5,607	7,029		
Commercial real estate	870	1,702		
Total real estate owned	23,147	35,974		
Total non-performing assets	\$ 80,569	\$ 110,642		
Total accruing troubled debt restructurings	\$ 25,356	\$ 16,011		
Total non-accrual loans to total loans, net	5.26	%	6.59	%
Total non-accrual loans and accruing troubled debt restructurings to total loans receivable	7.58	%	8.00	%
Total non-accrual loans to total assets	3.59	%	4.50	%
Total non-performing assets to total assets	5.04	%	6.66	%

The following table sets forth activity in our non-accrual loans for the periods indicated.

At or for the Nine Months Ended September 30, 2013      2012 (In Thousands)	
\$ 74,668	\$ 78,218

Balance at beginning of period		
Additions	29,494	36,044
Transfers to real estate owned	(10,117)	(19,729)
Charge-offs	(10,908)	(6,083 )
Returned to accrual status	(20,702)	(8,043 )
Principal paydowns and other	(5,013 )	(6,779 )
Balance at end of period	\$ 57,422	\$ 73,628

Total non-accrual loans decreased by \$17.2 million, or 23.1%, to \$57.4 million as of September 30, 2013 compared to \$74.7 million as of December 31, 2012. The ratio of non-accrual loans to total loans receivable was 5.26% at September 30, 2013 compared to 6.59% at December 31, 2012. During the nine months ended September 30, 2013, \$20.7 million of loans were returned to accrual status, \$10.1 million were transferred to real estate owned (net of charge-offs), \$10.9 million in loan principal was charged off and \$5.0 million in principal payments were

received. Offsetting this activity, \$29.5 million of loans were placed on non-accrual status during the nine months ended September 30, 2013.

Of the \$57.4 million in total non-accrual loans as of September 30, 2013, \$50.3 million of 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 \$10.2 million in partial charge-offs have been recorded with respect to these loans as of September 30, 2013. 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 \$4.0 million have been recorded as of September 30, 2013. The remaining \$7.2 million of non-accrual loans were reviewed on an aggregate basis and \$1.9 million in general valuation allowance was deemed necessary related to those loans as of September 30, 2013. The \$1.9 million in general valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

Our largest non-accrual loan as of September 30, 2013 was collateralized by multi-family estate located in southeastern Wisconsin. This loan had a principal balance of \$3.9 million at September 30, 2013 and a specific valuation allowance of \$386,000. The loan is currently performing in accordance with modified terms under a troubled debt restructuring. Our second largest non-accrual loan as of September 30, 2013 was collateralized by a single-family residence located in Idaho. This loan had a principal balance of \$1.8 million at September 30, 2013. Based upon an updated valuation, the estimated net realizable value of the collateral exceeds the principal balance of the loan, thus a specific valuation was not deemed necessary as of September 30, 2013. Our third largest non-accrual loan as of September 30, 2013 was collateralized by a single-family residence located in southeastern Wisconsin. This loan had a principal balance of \$1.6 million and a specific valuation allowance of \$418,000 at September 30, 2013. Our fourth largest non-accrual loan as of September 30, 2013 was collateralized by multi-family real estate located in southeastern Wisconsin with a principal balance of \$1.5 million. Based upon an updated valuation, the estimated net realizable value of the collateral exceeds the principal balance of the loan, thus a specific valuation was not deemed necessary as of September 30, 2013. Our next largest non-accrual loan as of September 30, 2013 was collateralized by improved land held for development, located in southeastern Wisconsin. This loan had a principal balance of \$1.4 million at September 30, 2013, which is net of life-to-date charge offs of \$1.5 million. Together, these five largest non-accrual loans comprised 17.6% of total non-accrual loans at September 30, 2013.

For the nine months ended September 30, 2013, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$2.7 million. We recognized \$1.8 million of interest income on such loans during the nine months ended September 30, 2013.

There were no accruing loans past due 90 days or more during the nine months ended September 30, 2013 or 2012.

Troubled Debt Restructurings. The following table summarizes troubled debt restructurings.

At September 30, 2013	At December 31, 2012
(In Thousands)	

Troubled debt restructurings		
Substandard	\$ 29,235	\$ 48,449
Watch	18,444	11,172
Total troubled debt restructurings	\$ 47,679	\$ 59,621

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

	At September 30, 2013		At December 31, 2012	
	Non- Accruing	Accruing	Non- Accruing	Accruing
	(In Thousands)			
Troubled Debt Restructurings:				
Residential				
One- to four-family	\$ 14,007	\$ 8,024	\$ 21,847	\$ 9,921
Multi-family	6,227	15,924	20,030	3,917
Home equity	992	—	986	—
Construction and land	840	1,408	79	2,173
Commercial real estate	257	—	668	—
Commercial	—	—	—	—
Total	\$ 22,323	\$ 25,356	\$ 43,610	\$ 16,011

The following table sets forth activity in our troubled debt restructurings for the periods indicated.

	At or for the Nine Months Ended September 30, 2013	
	Non- Accrual	Accrual
	(In Thousands)	
Balance at beginning of period	\$ 16,011	\$ 43,609
Additions	329	1,560
Change in accrual status	15,385	(15,385)
Charge-offs	(102 )	(2,554 )
Returned to contractual/market terms	(4,921 )	(1,927 )
Transferred to real estate owned	—	(2,092 )
Principal paydowns and other	(1,346 )	(888 )
Balance at end of period	\$ 25,356	\$ 22,323

For the nine months ended September 30, 2013, gross interest income that would have been recorded had our troubled debt restructurings been current in accordance with their original terms was \$2.2 million. We recognized \$1.5 million



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of interest income on such loans during the nine months ended September 30, 2013.

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

	At September 30, 2013	At December 31, 2012
	(Dollars in Thousands)	
Loans past due less than 90 days	\$ 13,538	\$ 23,092
Loans past due 90 days or more	35,343	51,358
Total loans past due	\$ 48,881	\$ 74,450
Total loans past due to total loans receivable	4.48 %	6.57 %

Past due loans decreased by \$25.6 million, or 34.3%, to \$48.9 million at September 30, 2013 from \$74.5 million at December 31, 2012. Loans past due 90 days or more decreased by \$16.0 million, or 31.1%, during the nine months ended September 30, 2013 while loans past due less than 90 days decreased by \$9.6 million, or 41.4%. The \$16.0 million decrease in loans past due 90 days or more was primarily due to an \$11.0 million lending relationship that was brought current under the terms of a troubled debt restructuring during the three months ended September 30, 2013. The \$9.6 million decrease in loans past due less than 90 days or more was primarily attributable to an \$8.0 million decrease in loans collateralized by one- to four-family residential real estate.

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

	At or for the Nine Months Ended September 30,	
	2013	2012
	(Dollars in Thousands)	
Balance at beginning of period	\$ 31,043	\$ 32,430
Provision for loan losses	3,960	7,100
Charge-offs:		
Mortgage loans		
One- to four-family	7,986	5,522
Multi-family	1,267	1,038
Home equity	575	375
Construction and land	128	816
Commercial real estate	1,366	1,661
Consumer	—	4
Commercial	6	59
Total charge-offs	11,328	9,475
Recoveries:		
Mortgage loans		
One- to four-family	694	305
Multi-family	205	55
Home equity	73	12
Construction and land	51	250
Commercial real estate	—	—
Consumer	5	—
Commercial	5	290
Total recoveries	1,033	912
Net charge-offs	10,295	8,563
Allowance at end of period	\$ 24,708	\$ 30,967

Ratios:

Allowance for loan losses to non-performing loans at end of period	43.03 %	42.06 %
Allowance for loan losses to loans outstanding at end of period	2.26 %	2.68 %
Net charge-offs to average loans outstanding (annualized)	1.12 %	0.89 %
Current period provision for loan losses to net charge-offs	38.46 %	82.91 %
Net charge-offs to beginning of the period allowance (annualized)	44.34 %	35.30 %

At September 30, 2013, the allowance for loan losses was \$24.7 million, compared to \$31.0 million at December 31, 2012. As of September 30, 2013, the allowance for loan losses represented 2.26% of total loans receivable and was equal to 43.03% of non-performing loans, compared to 2.74% and 41.58%, respectively, at December 31, 2012. The \$6.3 million decrease in the allowance for loan losses during the nine months ended September 30, 2013 reflects improvement in both the quality of the loan portfolio as well as the overall local real estate market. We have experienced improvement in a number of key loan-related loan quality metrics compared to September 30, 2012, 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 \$10.3 million, or an annualized 1.12% of average loans for the nine months ended September 30, 2013, compared to \$8.6 million, or an annualized 0.89% of average loans for the nine months ended September 30, 2012. Of the \$10.3 million in net charge-offs during the nine months ended September 30, 2013, approximately 71% of the activity related to loans secured by one- to four-family residential loans.

## FORWARD-LOOKING STATEMENTS

This proxy statement/prospectus contains forward-looking statements, which can be identified by the use of words such as “estimate,” “project,” “believe,” “intend,” “anticipate,” “plan,” “seek,” “expect” and words of similar meaning. These forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on current beliefs and expectations of our management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change.

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

- general economic conditions, either nationally or in our market areas, that are worse than expected;
  - competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins and yields, our mortgage banking revenues or reduce the fair value of financial instruments or reduce the origination levels in our lending business, or increase the level of defaults, losses and prepayments on loans we have made and make whether held in portfolio or sold in the secondary markets;
  - adverse changes in the securities or secondary mortgage markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
  - our ability to manage market risk, credit risk and operational risk in the current economic conditions;
  - our ability to enter new markets successfully and capitalize on growth opportunities;
  - our ability to successfully integrate acquired entities;
  - changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission or the Public Company Accounting Oversight Board;

- our ability to retain key employees;

- significant increases in our loan losses; and
- changes in the financial condition, results of operations or future prospects of issuers of securities that we own.

Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements. Please see “Risk Factors” beginning on page 21.

#### HOW WE INTEND TO USE THE PROCEEDS FROM THE OFFERING

Although we cannot determine what the actual net proceeds from the sale of the shares of common stock in the offering will be until the offering is completed, we anticipate that the net proceeds will be between \$180.2 million and \$244.4 million.

We intend to distribute the net proceeds as follows:

	Based Upon the Sale at \$10.00 Per Share of					
	18,700,000 Shares		22,000,000 Shares		25,300,000 Shares	
	Percent of Net		Percent of Net		Percent of Net	
	Amount	Proceeds	Amount	Proceeds	Amount	Proceeds
	(Dollars in thousands)					
Offering proceeds	\$187,000		\$220,000		\$253,000	
Less offering expenses	(6,820 )		(7,731 )		(8,642 )	
Net offering proceeds	\$180,180	100.0%	\$212,269	100.0%	\$244,358	100.0%
Distribution of net proceeds:						
To WaterStone Bank	\$90,090	50.0 %	\$106,135	50.0 %	\$122,179	50.0 %
To fund loan to employee stock ownership plan	\$14,960	8.3 %	\$17,600	8.3 %	\$20,240	8.3 %
Retained by New Waterstone (1)	\$75,130	41.7 %	\$88,535	41.7 %	\$101,939	41.7 %

(1) In the event the stock-based benefit plan providing for stock awards and stock options is approved by stockholders, and assuming shares are purchased for the stock awards at \$10.00 per share, an additional \$7.5 million, \$8.8 million and \$10.1 million of net proceeds will be used by New Waterstone. In this case, the net proceeds retained by New Waterstone would be \$67.7 million, \$79.7 million and \$91.8 million, respectively, at the minimum, midpoint and maximum of the offering range.

Payments for shares of common stock made through withdrawals from existing deposit accounts will not result in the receipt of new funds for investment but will result in a reduction of WaterStone Bank’s deposits. The net proceeds may vary because total expenses relating to the offering may be more or less than our estimates. For example, our expenses would increase if fewer shares were sold in the subscription and community offerings and more in the syndicated or firm commitment underwritten offering than we have assumed.

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New Waterstone may use the proceeds it retains from the offering:

- to invest in securities;
- to pay cash dividends to stockholders, subject to the receipt of any required regulatory approvals;
- to repurchase shares of our common stock, subject to the receipt of any required regulatory approvals;
- to finance the acquisition of financial institutions, although we do not currently have any agreements or understandings regarding any specific acquisition transaction; and
- for other general corporate purposes.



See “Our Dividend Policy” for a discussion of our expected dividend policy following the completion of the conversion. Under current federal regulations, we may not repurchase shares of our common stock during the first year following the completion of the conversion, except when extraordinary circumstances exist and with prior regulatory approval, or except to fund management recognition plans (which would require notification to the Federal Reserve Board) or tax qualified employee stock benefit plans.

WaterStone Bank may use the net proceeds it receives from the offering:

- to fund new loans;
- to enhance existing products and services and to support the development of new products and services;
- to expand its retail banking franchise by establishing or acquiring new branches or by acquiring other financial institutions or other financial services companies as opportunities arise, although we do not currently have any understandings or agreements to acquire a financial institution or other entity;
- to invest in securities; and
- for other general corporate purposes.

Initially, a substantial portion of the net proceeds will be invested in short-term investments, investment-grade debt obligations and mortgage-backed securities. We have not determined specific amounts of the net proceeds that would be used for the purposes described above. The use of the proceeds outlined above may change based on many factors, including, but not limited to, changes in interest rates, equity markets, laws and regulations affecting the financial services industry, the attractiveness of potential acquisitions to expand our operations, and overall market conditions. The use of the proceeds may also change depending on our ability to receive regulatory approval to establish new branches or acquire other financial institutions.

We expect our return on equity to be low until we are able to reinvest effectively the additional capital raised in the offering. Until we can increase our net interest income and non-interest income, we expect our return on equity to be below the industry average, which may negatively affect the value of our common stock. See “Risk Factors—Risks Related to the Offering—Our failure to effectively deploy the net proceeds may have an adverse effect on our financial performance.”

#### OUR DIVIDEND POLICY

After the completion of the conversion, we intend to pay cash dividends on a quarterly basis. Initially, we expect the quarterly dividends to be \$0.05 per share, which equals \$0.20 per share on an annualized basis and an annual yield of 2.0% based on a price of \$10.00 per share.

The dividend rate and the initial and continued payment of dividends will depend on a number of factors, including the receipt of any necessary regulatory approval to pay dividends, our capital requirements, our financial condition and results of operations, tax considerations, statutory and regulatory limitations, and general economic conditions. We cannot assure you that we will receive regulatory approval to pay dividends in the future or when such approval may be obtained, or that any such dividends will not be reduced or eliminated in the future.

New Waterstone will not be permitted to pay dividends on its common stock if its stockholders' equity would be reduced below the amount of the liquidation account established by New Waterstone in connection with the conversion. The source of dividends will depend on the net proceeds retained by New Waterstone and earnings thereon, and dividends from WaterStone Bank. In addition, New Waterstone will be subject to state law limitations and federal bank regulatory policy on the payment of dividends. Maryland law generally limits dividends if the

corporation would not be able to pay its debts in the usual course of business after giving effect to the dividend or if the corporation's total assets would be less than the corporation's total liabilities plus the amount needed to satisfy the preferential rights upon dissolution of stockholders whose preferential rights on dissolution are superior to those receiving the distribution.

Waterstone-Federal has adopted board resolutions that require regulatory approval from the Federal Reserve Board prior to the payment of cash dividends. See "Supervision and Regulation—Regulatory Developments."

After the completion of the conversion, WaterStone Bank will not be permitted to pay dividends on its capital stock to New Waterstone, its sole stockholder, if WaterStone Bank's stockholder's equity would be reduced below the amount of the liquidation account established in connection with the conversion. In addition, WaterStone Bank will not be permitted to make a capital distribution if, after making such distribution, it would be undercapitalized. WaterStone Bank must file an application with the Federal Deposit Insurance Corporation for approval of a capital distribution if the total capital distributions for the applicable calendar year exceed the sum of WaterStone Bank's net income for that year to date plus its retained net income for the preceding two years, or WaterStone Bank would not be at least adequately capitalized following the distribution. Under Wisconsin law and applicable regulations, WaterStone Bank may declare dividends on capital stock based upon net profits, provided that its paid-in surplus equals its capital stock and that it meets its regulatory capital requirements. If WaterStone Bank's paid-in surplus 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 will be required before WaterStone Bank declares any dividends exceeding 50% of profits for any calendar year and before a stock dividend may be declared out of retained earnings.

Any payment of dividends by WaterStone Bank to New Waterstone that would be deemed to be drawn from WaterStone Bank's bad debt reserves established prior to 1988, if any, would require a payment of taxes at the then-current tax rate by WaterStone Bank on the amount of earnings deemed to be removed from the pre-1988 bad debt reserves for such distribution. WaterStone Bank does not intend to make any distribution that would create such a federal tax liability. See "Proposal 1 — Approval of the Plan of Conversion and Reorganization—Liquidation Rights." For further information concerning additional federal law and regulations regarding the ability of WaterStone Bank to make capital distributions, including the payment of dividends to New Waterstone, see "Taxation—Federal Taxation" and "Supervision and Regulation—Dividends."

We will file a consolidated federal tax return with WaterStone Bank. Accordingly, it is anticipated that any cash distributions made by us to our stockholders would be treated as cash dividends and not as a non-taxable return of capital for federal tax purposes. Additionally, pursuant to Federal Reserve Board regulations, during the three-year period following the conversion, we will not make any capital distribution to stockholders that would be treated by recipients as a tax-free return of capital for federal income tax purposes.

#### MARKET FOR THE COMMON STOCK

Waterstone-Federal's common stock is currently listed on the Nasdaq Global Select Market under the symbol "WSBF." Upon completion of the conversion, we expect the shares of common stock of New Waterstone will replace the existing shares of Waterstone-Federal and trade on the Nasdaq Global Select Market under the symbol "WSBF." In order to list our stock on the Nasdaq Global Select Market, we are required to have at least three broker-dealers who will make a market in our common stock. As of October 31, 2013, Waterstone-Federal had approximately 27 registered market makers in its common stock. Sandler O'Neill & Partners, L.P. and Robert W. Baird & Co.

Incorporated have advised us that they intend to make a market in our common stock following the offering, but are under no obligation to do so.

The following table sets forth the high and low trading prices for shares of Waterstone-Federal common stock for the periods indicated, as obtained from the Nasdaq Stock Market. We have never paid cash dividends on our common stock. As of the close of business on October 31, 2013, there were 31,349,317 shares of common stock outstanding, including 8,299,134 publicly held shares (shares held by stockholders other than Lamplighter Financial, MHC), and approximately 1,570 stockholders of record.

	Price Per Share	
	High	Low
2013		
Fourth quarter (through October 31, 2013)	\$ 10.92	\$ 10.00
Third quarter	\$ 11.09	\$ 9.63
Second quarter	\$ 10.16	\$ 7.59
First quarter	\$ 8.68	\$ 6.66
2012		
Fourth quarter	\$ 8.39	\$ 5.16
Third quarter	\$ 5.19	\$ 3.33
Second quarter	\$ 4.05	\$ 3.01
First quarter	\$ 3.18	\$ 1.78
2011		
Fourth quarter	\$ 2.69	\$ 2.40
Third quarter	\$ 2.83	\$ 2.25
Second quarter	\$ 3.22	\$ 2.50
First quarter	\$ 3.80	\$ 1.80

On June 5, 2013, the business day immediately preceding the public announcement of the conversion, and on November 5, 2013, the closing prices of Waterstone-Federal common stock as reported on the Nasdaq Global Select Market were \$7.77 per share and \$10.64 per share, respectively. On the effective date of the conversion, all publicly held shares of Waterstone-Federal common stock, including shares of common stock held by our officers and directors, will be converted automatically into and become the right to receive a number of shares of New Waterstone common stock determined pursuant to the exchange ratio. See “Proposal 1 — Approval of the Plan of Conversion and Reorganization—Share Exchange Ratio for Current Stockholders.” Options to purchase shares of Waterstone-Federal common stock will be converted into options to purchase a number of shares of New Waterstone common stock determined pursuant to the exchange ratio, for the same aggregate exercise price. See “Beneficial Ownership of Common Stock.”

## HISTORICAL AND PRO FORMA REGULATORY CAPITAL COMPLIANCE

At June 30, 2013, WaterStone Bank exceeded all of the applicable regulatory capital requirements and was considered “well capitalized.” The table below sets forth the historical equity capital and regulatory capital of WaterStone Bank at June 30, 2013, and the pro forma equity capital and regulatory capital of WaterStone Bank, after giving effect to the sale of shares of common stock at \$10.00 per share. The table assumes the receipt by WaterStone Bank of 50% of the net offering proceeds. See “How We Intend to Use the Proceeds from the Offering.”

	WaterStone Bank Historical at June 30, 2013			Pro Forma at June 30, 2013, Based Upon the Sale in the Offering of								
	Amount	Percent of Assets (1)		18,700,000 Shares Amount	Percent of Assets (1)		22,000,000 Shares Amount	Percent of Assets (1)		25,300,000 Shares Amount	Percent of Assets (1)	
(Dollars in thousands)												
Equity	\$201,626	12.38 %		\$291,716	16.97 %		\$307,761	17.74 %		\$323,805	18.50 %	
Tier 1 leverage capital	\$197,060	12.17 %		\$287,150	16.80 %		\$303,195	17.57 %		\$319,239	18.33 %	
Leverage requirement	80,964	5.00		85,469	5.00		86,271	5.00		87,073	5.00	
Excess	\$116,096	7.17 %		\$201,682	11.80 %		\$216,924	12.57 %		\$232,166	13.33 %	
Tier 1 risk-based capital (2)	\$197,060	17.61 %		\$287,150	25.25 %		\$303,195	26.59 %		\$319,239	27.91 %	
Risk-based requirement	67,152	6.00		68,233	6.00		68,426	6.00		68,619	6.00	
Excess	\$129,908	11.61 %		\$218,917	19.25 %		\$234,769	20.59 %		\$250,620	21.91 %	
Total risk-based capital (2)	\$211,222	18.87 %		\$301,312	26.50 %		\$317,357	27.83 %		\$333,401	29.15 %	
Risk-based requirement	111,921	10.00		113,722	10.00		114,043	10.00		114,364	10.00	
Excess	\$99,301	8.87 %		\$187,590	16.50 %		\$203,313	17.83 %		\$219,037	19.15 %	

(1) Equity and Tier 1 leverage capital levels are shown as a percentage of total average assets. Risk-based capital levels are shown as a percentage of risk-weighted assets.

(2) Pro forma amounts and percentages assume net proceeds are invested in assets that carry a 20% risk weighting.

## CAPITALIZATION

The following table presents the historical consolidated capitalization of Waterstone-Federal at June 30, 2013 and the pro forma consolidated capitalization of New Waterstone after giving effect to the conversion and offering based upon the assumptions set forth in the “Pro Forma Data” section.

	Waterstone-Federal Historical at June 30, 2013	Pro Forma at June 30, 2013 Based upon the Sale in the Offering at \$10.00 per Share of		
		18,700,000 Shares (Dollars in thousands)	22,000,000 Shares (Dollars in thousands)	25,300,000 Shares (Dollars in thousands)
Deposits (1)	\$ 893,007	\$ 893,007	\$ 893,007	\$ 893,007
Borrowed funds	490,046	490,046	490,046	490,046
Total deposits and borrowed funds	\$ 1,383,053	\$ 1,383,053	\$ 1,383,053	\$ 1,383,053
Stockholders' equity:				
Preferred stock, \$0.01 par value, 50,000,000 shares authorized (post-conversion) (2)	—	—	—	—
Common stock, \$0.01 par value, 100,000,000 shares authorized (post-conversion); shares to be issued as reflected (2) (3)	341	254	299	344
Additional paid-in capital (2)	110,438	245,705	277,749	309,793
MHC capital contribution	—	55	55	55
Retained earnings (4)	146,039	146,039	146,039	146,039
Accumulated other comprehensive income	(932 )	(932 )	(932 )	(932 )
Less:				
Treasury stock	(45,261 )	—	—	—
Common stock held by employee stock ownership plan (5)	(1,280 )	(16,240 )	(18,880 )	(21,520 )
Common stock to be acquired by stock-based benefit plan (6)	—	(7,480 )	(8,800 )	(10,120 )
Total stockholders' equity	\$ 209,345	\$ 367,140	\$ 395,269	\$ 423,398
Pro Forma Shares Outstanding				
Shares offered for sale	—	18,700,000	22,000,000	25,300,000
Exchange shares issued	—	6,731,209	7,919,069	9,106,929
Total shares outstanding	—	25,431,209	29,919,069	34,406,929
Total stockholders' equity as a percentage of total assets (1)				
	12.82 %	20.50 %	21.73 %	22.92 %
	12.78 %	20.47 %	21.70 %	22.89 %

Tangible equity as a percentage of  
total assets

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- (1) Does not reflect withdrawals from deposit accounts for the purchase of shares of common stock in the conversion and offering. These withdrawals would reduce pro forma deposits and assets by the amount of the withdrawals.
- (2) Waterstone-Federal currently has 20,000,000 authorized shares of preferred stock, par value \$0.01 per share, and 200,000,000 authorized shares of common stock, par value \$0.01 per share. On a pro forma basis, common stock and additional paid-in capital have been revised to reflect the number of shares of New Waterstone common stock to be outstanding.
- (3) No effect has been given to the issuance of additional shares of New Waterstone common stock pursuant to the exercise of options under one or more stock-based benefit plans. If the plans are implemented within the first year after the closing of the offering, an amount up to 10% of the shares of New Waterstone common stock sold in the offering will be reserved for issuance upon the exercise of options under the plans. No effect has been given to the exercise of options currently outstanding. See “Management.”
- (4) The retained earnings of WaterStone Bank will be substantially restricted after the conversion. See “Proposal 1 — Approval of the Plan of Conversion and Reorganization—Liquidation Rights” and “Supervision and Regulation—Capital Distributions.”

(footnotes continue on following page)



(continued from previous page)

- (5) Assumes that 8% of the shares sold in the offering will be acquired by the employee stock ownership plan financed by a loan from New Waterstone. The loan will be repaid principally from WaterStone Bank's contributions to the employee stock ownership plan. Since New Waterstone will finance the employee stock ownership plan debt, this debt will be eliminated through consolidation and no liability will be reflected on New Waterstone's consolidated financial statements. Accordingly, the amount of shares of common stock acquired by the employee stock ownership plan is shown in this table as a reduction of total stockholders' equity.
- (6) Assumes a number of shares of common stock equal to 4% of the shares of common stock to be sold in the offering will be purchased for grant by one or more stock-based benefit plans. The funds to be used by such plans to purchase the shares will be provided by New Waterstone. The dollar amount of common stock to be purchased is based on the \$10.00 per share subscription price in the offering and represents unearned compensation. This amount does not reflect possible increases or decreases in the value of common stock relative to the subscription price in the offering. New Waterstone will accrue compensation expense to reflect the vesting of shares pursuant to such stock-based benefit plans and will credit capital in an amount equal to the charge to operations. Implementation of such plans will require stockholder approval.

### PRO FORMA DATA

The following tables summarize historical data of Waterstone-Federal and pro forma data of New Waterstone at and for the six months ended June 30, 2013 and at and for the year ended December 31, 2012. This information is based on assumptions set forth below and in the tables, and should not be used as a basis for projections of market value of the shares of common stock following the conversion and offering.

The net proceeds in the tables are based upon the following assumptions:

- (i) 50% of all shares of common stock will be sold in the subscription and community offerings and 50% will be sold in the syndicated or firm commitment underwritten offering;
- (ii) our executive officers and directors, and their associates, will purchase 198,500 shares of common stock;
- (iii) our employee stock ownership plan will purchase 8% of the shares of common stock sold in the offering with a loan from New Waterstone. The loan will be repaid in substantially equal payments of principal and interest (at the prime rate of interest, calculated as of the date of the origination of the loan) over a period of 20 years. Interest income that we earn on the loan will offset the interest paid by WaterStone Bank;
- (iv) we will pay Sandler O'Neill & Partners, L.P. a fee equal to 1.0% of the aggregate amount of common stock sold in the subscription and community offerings (net of insider purchases and shares purchased by our employee stock ownership plan);
- (v) we will pay Sandler O'Neill & Partners, L.P., Robert W. Baird & Co. Incorporated and any other broker-dealers participating in the syndicated or firm commitment underwritten offering an aggregate fee of 5% of the aggregate dollar amount of the common stock sold in the syndicated or firm commitment underwritten offering;
- (vi) No fee will be paid with respect to shares of common stock purchased by our tax-qualified and non-qualified employee stock benefit plans, or stock purchased by our officers, directors and employees, and their immediate families, and no fee will be paid with respect to exchange shares; and
- (vii) total expenses of the offering, other than the fees and commissions to be paid to Sandler O'Neill & Partners, L.P., Robert W. Baird & Co. Incorporated and other broker-dealers, will be \$1.5 million.

We calculated pro forma consolidated net income for the six months ended June 30, 2013 and the year ended December 31, 2012 as if the estimated net proceeds we received had been invested at the beginning of the period at an assumed interest rate of 1.41% (0.85% on an after-tax basis) and 0.72% (0.43% on an after-tax basis), respectively. These figures represent the yield on the five-year U.S. Treasury Note as of June 30, 2013 and December 31, 2012, respectively, which, in light of current market interest rates, we consider to more accurately reflect the pro forma reinvestment rate than the arithmetic average of the weighted average yield earned on our interest earning assets and the weighted average rate paid on our deposits, which is the reinvestment rate generally required by federal regulations.

We further believe that the reinvestment rate is factually supportable because:

- the yield on the U.S Treasury Note can be determined and/or estimated from third-party sources; and

- we believe that U.S. Treasury securities are not subject to credit losses due to a U.S. Government guarantee of payment of principal and interest.

We calculated historical and pro forma per share amounts by dividing historical and pro forma amounts of consolidated net income and stockholders' equity by the indicated number of shares of common stock. For purposes of pro forma earnings per share calculations, we adjusted these figures to give effect to the shares of common stock purchased by the employee stock ownership plan. We computed per share amounts for each period as if the shares of common stock were outstanding at the beginning of each period, but we did not adjust per share historical or pro forma stockholders' equity to reflect the earnings on the estimated net proceeds.

The pro forma tables give effect to the implementation of one or more stock-based benefit plans. Subject to the receipt of stockholder approval, we have assumed that stock-based benefit plans will acquire for restricted stock awards a number of shares of common stock equal to 4% of the shares of common stock sold in the stock offering at the same price for which they were sold in the stock offering. We assume that awards of common stock granted under such plans vest over a five-year period.

We have also assumed that options will be granted under stock-based benefit plans to acquire shares of common stock equal to 10% of the shares of common stock sold in the stock offering. In preparing the tables below, we assumed that stockholder approval was obtained, that the exercise price of the stock options and the market price of the stock at the date of grant were \$10.00 per share and that the stock options had a term of ten years and vested over five years. We applied the Black-Scholes option pricing model to estimate a grant-date fair value of \$2.60 for each option. In addition to the terms of the options described above, the Black-Scholes option pricing model assumed an estimated volatility rate of 24.17% for the shares of common stock, a dividend yield of 2.0%, an expected option term of 10 years and a risk-free rate of return of 2.52%.

We may grant options and award shares of common stock under one or more stock-based benefit plans in excess of 10% and 4%, respectively, of the shares of common stock sold in the stock offering and that vest sooner than over a five-year period if the stock-based benefit plans are adopted more than one year following the stock offering.

As discussed under "How We Intend to Use the Proceeds from the Stock Offering," we intend to contribute 50% of the net proceeds from the stock offering to WaterStone Bank, and we will retain the remainder of the net proceeds from the stock offering. We will use a portion of the proceeds we retain for the purpose of making a loan to the employee stock ownership plan and retain the rest of the proceeds for future use.

The pro forma table does not give effect to:

- withdrawals from deposit accounts to purchase shares of common stock in the stock offering;
- our results of operations after the stock offering; or
- changes in the market price of the shares of common stock after the stock offering.

The following pro forma information may not be representative of the financial effects of the offering at the dates on which the offering actually occurs, and should not be taken as indicative of future results of operations. Pro forma consolidated stockholders' equity represents the difference between the stated amounts of our assets and liabilities. The pro forma stockholders' equity is not intended to represent the fair market value of the shares of common stock and may be different than the amounts that would be available for distribution to stockholders if we liquidated. Moreover, pro forma stockholders' equity per share does not give effect to the liquidation accounts to be established in the conversion or, in the unlikely event of a liquidation of WaterStone Bank, to the tax effect of the recapture of the bad debt reserve. See "Proposal 1 — Approval of the Plan of Conversion and Reorganization—Liquidation

Rights.”

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	At or for the Six Months Ended June 30, 2013		
	Based upon the Sale at \$10.00 Per Share of 18,700,000      22,000,000      25,300,000 Shares              Shares              Shares (Dollars in thousands, except per share amounts)		
Gross proceeds of offering	\$187,000	\$220,000	\$253,000
Market value of shares issued in the exchange	67,312	79,191	91,069
Pro forma market capitalization	\$254,312	\$299,191	\$344,069
Gross proceeds of offering	\$187,000	\$220,000	\$253,000
Expenses	(6,820 )	(7,731 )	(8,642 )
Estimated net proceeds	180,180	212,269	244,358
Assets received from mutual holding company	55	55	55
Common stock purchased by employee stock ownership plan	(14,960 )	(17,600 )	(20,240 )
Common stock purchased by stock-based benefit plans	(7,480 )	(8,800 )	(10,120 )
Estimated net proceeds, as adjusted	\$157,795	\$185,924	\$214,053
For the Six Months Ended June 30, 2013			
Consolidated net earnings:			
Historical	\$9,552	\$9,552	\$9,552
Income on adjusted net proceeds	667	786	905
Employee stock ownership plan (1)	(56 )	(96 )	(136 )
Stock awards (2)	(449 )	(528 )	(607 )
Stock options (3)	(438 )	(515 )	(592 )
Pro forma net income	\$9,276	\$9,199	\$9,122
Earnings per share (4):			
Historical	\$0.40	\$0.34	\$0.29
Income on adjusted net proceeds	0.03	0.03	0.03
Employee stock ownership plan (1)	—	—	—
Stock awards (2)	(0.02 )	(0.02 )	(0.02 )
Stock options (3)	(0.02 )	(0.02 )	(0.02 )
Pro forma earnings per share (4)	\$0.39	\$0.33	\$0.28
Offering price to pro forma net earnings per share	12.82 x	15.15 x	17.86 x
Number of shares used in earnings per share calculations	23,972,609	28,203,069	32,433,529
At June 30, 2013			
Stockholders' equity:			
Historical	\$209,345	\$209,345	\$209,345
Estimated net proceeds	180,180	212,269	244,358
Equity increase from the mutual holding company	55	55	55
Common stock acquired by employee stock ownership plan (1)	(14,960 )	(17,600 )	(20,240 )
Common stock acquired by stock-based benefit plans (2)	(7,480 )	(8,800 )	(10,120 )

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Pro forma stockholders' equity	\$367,140	\$395,269	\$423,398
Intangible assets	\$(601 )	\$(601 )	\$(601 )
Pro forma tangible stockholders' equity (5)	\$366,539	\$394,668	\$422,797
Stockholders' equity per share (6):			
Historical	\$8.23	\$7.00	\$6.08
Estimated net proceeds	7.08	7.09	7.10
Equity increase from the mutual holding company	—	—	—
Common stock acquired by employee stock ownership plan (1)	(0.59 )	(0.59 )	(0.59 )
Common stock acquired by stock-based benefit plans (2)	(0.29 )	(0.29 )	(0.29 )
Pro forma stockholders' equity per share (5) (6)	\$14.43	\$13.21	\$12.30
Intangible assets	\$(0.02 )	\$(0.02 )	\$(0.02 )
Pro forma tangible stockholders' equity per share (5) (6)	\$14.41	\$13.19	\$12.28
Offering price as percentage of pro forma stockholders' equity per share	69.30 %	75.70 %	81.30 %
Offering price as percentage of pro forma tangible stockholders' equity per share	69.40 %	75.82 %	81.43 %
Number of shares outstanding for pro forma book value per share calculations	25,431,209	29,919,069	34,406,929

(footnotes begin on following page)

- (1) Assumes that 8% of the shares of common stock sold in the offering will be purchased by the employee stock ownership plan. For purposes of this table, the funds used to acquire these shares are assumed to have been borrowed by the employee stock ownership plan from New Waterstone, and the outstanding loan with respect to existing shares of Waterstone-Federal held by the employee stock ownership plan will be refinanced and consolidated with the new loan from New Waterstone. WaterStone Bank intends to make annual contributions to the employee stock ownership plan in an amount at least equal to the required principal and interest payments on the debt. WaterStone Bank's total annual payments on the employee stock ownership plan debt are based upon 20 equal annual installments of principal and interest. Financial Accounting Standards Board Accounting Standards Codification ("ASC") 718-40, "Compensation—Stock Compensation—Employee Stock Ownership Plans" ("ASC 718-40") requires that an employer record compensation expense in an amount equal to the fair value of the shares committed to be released to employees. The pro forma adjustments assume that the employee stock ownership plan shares are allocated in equal annual installments based on the number of loan repayment installments assumed to be paid by WaterStone Bank, the fair value of the common stock remains equal to the subscription price and the employee stock ownership plan expense reflects an effective combined federal and state tax rate of 40.0%. The unallocated employee stock ownership plan shares are reflected as a reduction of stockholders' equity. No reinvestment is assumed on proceeds contributed to fund the employee stock ownership plan. The pro forma net income further assumes that 37,400, 44,000 and 50,600 shares were committed to be released during the period at the minimum, midpoint and maximum of the offering range, respectively, and in accordance with ASC 718-40, only the employee stock ownership plan shares committed to be released during the period were considered outstanding for purposes of net income per share calculations.
- (2) Assumes that one or more stock-based benefit plans purchase an aggregate number of shares of common stock equal to 4% of the shares to be sold in the offering. Stockholder approval of the plans and purchases by the plans may not occur earlier than six months after the completion of the conversion. The shares may be acquired directly from New Waterstone or through open market purchases. Shares in the stock-based benefit plan are assumed to vest over a period of five years. The funds to be used to purchase the shares will be provided by New Waterstone. The table assumes that (i) the stock-based benefit plan acquires the shares through open market purchases at \$10.00 per share, (ii) 10% of the amount contributed to the plan is amortized as an expense during the six months ended June 30, 2013, and (iii) the plan expense reflects an effective combined federal and state tax rate of 40.0%. Assuming stockholder approval of the stock-based benefit plans and that shares of common stock (equal to 4% of the shares sold in the offering) are awarded through the use of authorized but unissued shares of common stock, stockholders would have their ownership and voting interests diluted by approximately 2.9%.
- (3) Assumes that options are granted under one or more stock-based benefit plans to acquire an aggregate number of shares of common stock equal to 10% of the shares to be sold in the offering. Stockholder approval of the plans may not occur earlier than six months after the completion of the conversion. In calculating the pro forma effect of the stock-based benefit plans, it is assumed that the exercise price of the stock options and the trading price of the common stock at the date of grant were \$10.00 per share, the estimated grant-date fair value determined using the Black-Scholes option pricing model was \$2.60 for each option, the aggregate grant-date fair value of the stock options was amortized to expense on a straight-line basis over a five-year vesting period of the options, and that 25% of the amortization expense (or the assumed portion relating to options granted to directors) resulted in a tax benefit using an assumed tax rate of 40.0%. The actual expense will be determined by the grant-date fair value of the options, which will depend on a number of factors, including the valuation assumptions used and the option pricing model ultimately adopted. Under the above assumptions, the adoption of the stock-based benefit plans will result in no additional shares under the treasury stock method for purposes of calculating earnings per share. There can be no assurance that the actual exercise price of the stock options will be equal to the \$10.00 price per share. If a portion of the shares used to satisfy the exercise of options comes from authorized but unissued shares, our net income per share and stockholders' equity per share would decrease. The issuance of authorized but unissued shares of common stock pursuant to the exercise of options under such plan would dilute stockholders' ownership



and voting interests by approximately 6.9%.

(footnotes continue on following page)

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- (4) Per share figures include publicly held shares of Waterstone-Federal common stock that will be exchanged for shares of New Waterstone common stock in the conversion. See “Proposal 1 — Approval of the Plan of Conversion and Reorganization—Share Exchange Ratio for Current Stockholders.” Net income per share computations are determined by taking the number of shares assumed to be sold in the offering and the number of new shares assumed to be issued in exchange for publicly held shares and, in accordance with ASC 718-40, subtracting the employee stock ownership plan shares which have not been committed for release during the year. See note 1. The number of shares of common stock actually sold and the corresponding number of exchange shares may be more or less than the assumed amounts. Pro forma net income per share has been annualized to calculate the offering price to pro forma net earnings per share.
- (5) The retained earnings of WaterStone Bank will be substantially restricted after the conversion. See “Our Dividend Policy,” “Proposal 1 — Approval of the Plan of Conversion and Reorganization—Liquidation Rights” and “Supervision and Regulation—Capital Distributions.”
- (6) Per share figures include publicly held shares of Waterstone-Federal common stock that will be exchanged for shares of New Waterstone common stock in the conversion. Stockholders’ equity per share calculations are based upon the sum of (i) the number of shares assumed to be sold in the offering and (ii) shares to be issued in exchange for publicly held shares at the minimum, midpoint and maximum of the offering range, respectively. The exchange shares reflect an exchange ratio of 0.8111, 0.9542 and 1.0973 at the minimum, midpoint and maximum of the offering range, respectively. The number of shares actually sold and the corresponding number of exchange shares may be more or less than the assumed amounts.

	At or for the Year Ended December 31, 2012 Based upon the Sale at \$10.00 Per Share of 18,700,000      22,000,000      25,300,000 Shares              Shares              Shares (Dollars in thousands, except per share amounts)		
Gross proceeds of offering	\$187,000	\$220,000	\$253,000
Market value of shares issued in the exchange	67,312	79,191	91,069
Pro forma market capitalization	\$254,312	\$299,191	\$344,069
Gross proceeds of offering	\$187,000	\$220,000	\$253,000
Expenses	(6,820 )	(7,731 )	(8,642 )
Estimated net proceeds	180,180	212,269	244,358
Assets received from mutual holding company	55	55	55
Common stock purchased by employee stock ownership plan	(14,960 )	(17,600 )	(20,240 )
Common stock purchased by stock-based benefit plans	(7,480 )	(8,800 )	(10,120 )
Estimated net proceeds, as adjusted	\$157,795	\$185,924	\$214,053
For the Year Ended December 31, 2012			
Consolidated net earnings:			
Historical	\$34,914	\$34,914	\$34,914
Income on adjusted net proceeds	681	803	924
Employee stock ownership plan (1)	(284 )	(363 )	(442 )
Stock awards (2)	(898 )	(1,056 )	(1,214 )
Stock options (3)	(875 )	(1,030 )	(1,184 )
Pro forma net income	\$33,538	\$33,268	\$32,998
Earnings per share (4):			
Historical	\$1.45	\$1.24	\$1.07
Income on adjusted net proceeds	0.03	0.03	0.03
Employee stock ownership plan (1)	(0.01 )	(0.01 )	(0.01 )
Stock awards (2)	(0.04 )	(0.04 )	(0.04 )
Stock options (3)	(0.04 )	(0.04 )	(0.04 )
Pro forma earnings per share (4)	\$1.39	\$1.18	\$1.01
Offering price to pro forma net earnings per share	7.19 x	8.47 x	9.90 x
Number of shares used in earnings per share calculations	24,010,009	28,247,069	32,484,129
At December 31, 2012			
Stockholders' equity:			
Historical	\$202,634	\$202,634	\$202,634
Estimated net proceeds	180,180	212,269	244,358
Equity increase from the mutual holding company	55	55	55
Common stock acquired by employee stock ownership plan (1)	(14,960 )	(17,600 )	(20,240 )
Common stock acquired by stock-based benefit plans (2)	(7,480 )	(8,800 )	(10,120 )

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Pro forma stockholders' equity	\$360,429	\$388,558	\$416,687
Intangible assets	\$(601 )	\$(601 )	\$(601 )
Pro forma tangible stockholders' equity (5)	\$359,828	\$387,957	\$416,086
Stockholders' equity per share (6):			
Historical	\$7.97	\$6.77	\$5.89
Estimated net proceeds	7.08	7.09	7.10
Equity increase from the mutual holding company	—	—	—
Common stock acquired by employee stock ownership plan (1)	(0.59 )	(0.59 )	(0.59 )
Common stock acquired by stock-based benefit plans (2)	(0.29 )	(0.29 )	(0.29 )
Pro forma stockholders' equity per share (5) (6)	\$14.17	\$12.98	\$12.11
Intangible assets	\$(0.02 )	\$(0.02 )	\$(0.02 )
Pro forma tangible stockholders' equity per share (5) (6)	\$14.15	\$12.96	\$12.09
Offering price as percentage of pro forma stockholders' equity per share	70.57 %	77.04 %	82.58 %
Offering price as percentage of pro forma tangible stockholders' equity per share	70.67 %	77.16 %	82.71 %
Number of shares outstanding for pro forma book value per share calculations	25,431,209	29,919,069	34,406,929

(footnotes begin on following page)

- (1) Assumes that 8% of the shares of common stock sold in the offering will be purchased by the employee stock ownership plan. For purposes of this table, the funds used to acquire these shares are assumed to have been borrowed by the employee stock ownership plan from New Waterstone, and the outstanding loan with respect to existing shares of Waterstone-Federal held by the employee stock ownership plan will be refinanced and consolidated with the new loan from New Waterstone. WaterStone Bank intends to make annual contributions to the employee stock ownership plan in an amount at least equal to the required principal and interest payments on the debt. WaterStone Bank's total annual payments on the employee stock ownership plan debt are based upon 20 equal annual installments of principal and interest. ASC 718-40 requires that an employer record compensation expense in an amount equal to the fair value of the shares committed to be released to employees. The pro forma adjustments assume that the employee stock ownership plan shares are allocated in equal annual installments based on the number of loan repayment installments assumed to be paid by WaterStone Bank, the fair value of the common stock remains equal to the subscription price and the employee stock ownership plan expense reflects an effective combined federal and state tax rate of 40.0%. The unallocated employee stock ownership plan shares are reflected as a reduction of stockholders' equity. No reinvestment is assumed on proceeds contributed to fund the employee stock ownership plan. The pro forma net income further assumes that 74,800, 88,000 and 101,200 shares were committed to be released during the year at the minimum, midpoint and maximum of the offering range, respectively, and in accordance with ASC 718-40, only the employee stock ownership plan shares committed to be released during the period were considered outstanding for purposes of net income per share calculations.
- (2) Assumes that one or more stock-based benefit plans purchase an aggregate number of shares of common stock equal to 4% of the shares to be sold in the offering. Stockholder approval of the plans and purchases by the plans may not occur earlier than six months after the completion of the conversion. The shares may be acquired directly from New Waterstone or through open market purchases. Shares in the stock-based benefit plan are assumed to vest over a period of five years. The funds to be used to purchase the shares will be provided by New Waterstone. The table assumes that (i) the stock-based benefit plan acquires the shares through open market purchases at \$10.00 per share, (ii) 20% of the amount contributed to the plan is amortized as an expense during the year ended December 31, 2012, and (iii) the plan expense reflects an effective combined federal and state tax rate of 40.0%. Assuming stockholder approval of the stock-based benefit plans and that shares of common stock (equal to 4% of the shares sold in the offering) are awarded through the use of authorized but unissued shares of common stock, stockholders would have their ownership and voting interests diluted by approximately 2.9%.
- (3) Assumes that options are granted under one or more stock-based benefit plans to acquire an aggregate number of shares of common stock equal to 10% of the shares to be sold in the offering. Stockholder approval of the plans may not occur earlier than six months after the completion of the conversion. In calculating the pro forma effect of the stock-based benefit plans, it is assumed that the exercise price of the stock options and the trading price of the common stock at the date of grant were \$10.00 per share, the estimated grant-date fair value determined using the Black-Scholes option pricing model was \$2.60 for each option, the aggregate grant-date fair value of the stock options was amortized to expense on a straight-line basis over a five-year vesting period of the options, and that 25% of the amortization expense (or the assumed portion relating to options granted to directors) resulted in a tax benefit using an assumed tax rate of 40.0%. The actual expense will be determined by the grant-date fair value of the options, which will depend on a number of factors, including the valuation assumptions used and the option pricing model ultimately adopted. Under the above assumptions, the adoption of the stock-based benefit plans will result in no additional shares under the treasury stock method for purposes of calculating earnings per share. There can be no assurance that the actual exercise price of the stock options will be equal to the \$10.00 price per share. If a portion of the shares used to satisfy the exercise of options comes from authorized but unissued shares, our net income per share and stockholders' equity per share would decrease. The issuance of authorized but unissued shares of common stock pursuant to the exercise of options under such plan would dilute stockholders' ownership

and voting interests by approximately 6.9%.

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- (4) Per share figures include publicly held shares of Waterstone-Federal common stock that will be exchanged for shares of New Waterstone common stock in the conversion. See “Proposal 1 — Approval of the Plan of Conversion and Reorganization—Share Exchange Ratio for Current Stockholders.” Net income per share computations are determined by taking the number of shares assumed to be sold in the offering and the number of new shares assumed to be issued in exchange for publicly held shares and, in accordance with ASC 718-40, subtracting the employee stock ownership plan shares which have not been committed for release during the year. See note 1. The number of shares of common stock actually sold and the corresponding number of exchange shares may be more or less than the assumed amounts.
- (5) The retained earnings of WaterStone Bank will be substantially restricted after the conversion. See “Our Dividend Policy,” “Proposal 1 — Approval of the Plan of Conversion and Reorganization—Liquidation Rights” and “Supervision and Regulation—Capital Distributions.”
- (6) Per share figures include publicly held shares of Waterstone-Federal common stock that will be exchanged for shares of New Waterstone common stock in the conversion. Stockholders’ equity per share calculations are based upon the sum of (i) the number of shares assumed to be sold in the offering and (ii) shares to be issued in exchange for publicly held shares at the minimum, midpoint and maximum of the offering range, respectively. The exchange shares reflect an exchange ratio of 0.8111, 0.9542 and 1.0973 at the minimum, midpoint and maximum of the offering range, respectively. The number of shares actually sold and the corresponding number of exchange shares may be more or less than the assumed amounts.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis reflects our consolidated financial statements and other relevant statistical data, and is intended to enhance your understanding of our financial condition and results of operations. The information in this section has been derived from the audited and unaudited consolidated financial statements, which appear beginning on page F-1 of this proxy statement/prospectus. You should read the information in this section in conjunction with the business and financial information regarding Waterstone-Federal and the financial statements provided in this proxy statement/prospectus.

### 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. Our banking subsidiary, WaterStone Bank, is primarily a mortgage lender with loans secured by real estate comprising 98.3% of total loans receivable as of June 30, 2013. Further, 88.5% of loans receivable are residential mortgage loans with multi-family loans comprising 46.9% of all loans as of June 30, 2013. WaterStone Bank funds its loan originations primarily with retail deposits and Federal Home Loan Bank advances. On June 30, 2013, deposits comprised 62.7% of total liabilities. Time deposits, also known as certificates of deposit, accounted for 76.4% of total deposits as of June 30, 2013. Federal Home Loan Bank advances outstanding as of June 30, 2013 totaled \$350.0 million, or 24.6% of total liabilities. WaterStone Bank's mortgage banking subsidiary, Waterstone Mortgage Corporation, utilizes lines of credit provided by WaterStone Bank as a primary source of funding loans held for sale. In addition, Waterstone Mortgage Corporation utilizes lines of credit with other banks as needed. During the current prolonged period of low interest rates and economic weakness, our investment philosophy has emphasized short-term liquid investments, including cash and cash equivalents, which should position us to take advantage of investment, lending and interest rate risk management opportunities that may arise as the local and national economies continue to recover from the recession. Our high level of time deposits relative to total deposits would result in a greater increase in our cost of funds in a rising market interest rate environment.

During the six months ended June 30, 2013 and 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 loan losses, which resulted from a stabilization of our asset quality. Increases in sales volumes for 2013 and 2012 and higher margins earned during 2012 on the sale of mortgage loans in the secondary market yielded \$8.8 million, \$19.2 million and \$3.0 million in pre-tax earnings from our mortgage banking segment during the six months ended June 30, 2013 and the years ended December 31, 2012 and 2011, respectively.

Our provision for loan losses decreased \$13.8 million to \$8.3 million for the year ended December 31, 2012 compared to \$22.1 million for the year ended December 31, 2011, and was \$3.0 million for the six months ended June 30, 2013. The decrease in provision for loan losses reflects a stabilization in both the quality of our loan portfolio and the 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, loans contractually past due and non-accrual loans. In addition, the turnover of loans in each of the three aforementioned metrics has slowed, which has resulted in fewer loans requiring a specific collateral analysis to determine a potential collateral shortfall and loan loss reserve. Furthermore, as the local real estate market stabilized, 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.

Our results of operations for the year ended December 31, 2012 were also positively impacted by our recognizing a net income tax benefit of \$12.2 million despite recognizing pre-tax income of \$22.7 million for the

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year. The tax 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, as our analysis has concluded that it was more likely than not that net deferred tax assets would be realized in subsequent periods.

Partially 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 for 2012 resulted from a 20 basis point decrease in our net interest margin and a 22 basis point decrease in our net interest rate spread, as the yield on earning assets declined more rapidly than the cost of funds. This decrease in our net interest rate margin and spread was only partially offset by a \$25.5 million increase in our average net interest earning assets during 2012 compared to 2011. Net interest income decreased \$988,000 to \$20.1 million for the six months ended June 30, 2013 from \$21.1 million for the six months ended June 30, 2012.

### Business Strategy

Our goal is to build stockholder value by operating a well-capitalized and profitable financial institution that delivers a superior banking experience to our customers. Beginning in 2007, due to the adverse economic environment, we experienced significant increases in non-performing assets, which resulted in net losses and increased regulatory oversight. In response, we concentrated our efforts on resolving problem assets, curtailing growth, and preserving a strong capital position. We have made significant progress in our efforts while simultaneously building our mortgage banking business, which resulted in a return to profitability in 2012. Net income for the year ended December 31, 2012 was \$34.9 million (which reflected a reversal of a valuation allowance on our deferred tax assets of \$17.0 million), and for the six months ended June 30, 2013 net income was \$9.6 million.

Our current principal business strategies are summarized below:

Continued reduction of problem assets. Our strategy with respect to non-performing loans is to work with borrowers to return loans to performing status when possible, including through temporary forbearance or troubled debt restructurings. If a loan cannot be returned to performing status, we foreclose on the loan, taking the collateral into real estate owned. In an effort to strengthen our oversight of problem assets and minimize overall costs and expenses as well as any loss on the sale of real estate owned, we have established an internal asset management group and an internal sales group to manage and market our real estate owned. These groups also enable our lenders to focus on loan originations instead of foreclosed asset management. Our non-performing assets have decreased to \$83.2 million, or 5.10% of total assets at June 30, 2013, from \$141.9 million, or 7.85% of total assets at December 31, 2010. Our non-performing assets at June 30, 2013 included \$53.3 million of non-performing loans and \$30.0 million of real estate owned. Of the \$53.3 million of non-accrual loans, \$20.9 million, or 39.2%, were troubled debt restructurings that were on non-accrual status either due to being past due 90 days or more or because they had not yet performed under the modified terms for a required period of time. At June 30, 2013, total troubled debt restructurings totaled \$47.1 million, of which \$39.9 million, or 84.7%, were performing in accordance with their restructured terms. Reducing our level of non-performing assets will continue to be a key element of our business strategy.

Controlled loan growth with a focus on multi-family and commercial real estate lending. Our principal business activity historically has been the origination of residential mortgage loans, including multi-family residential real estate loans, for retention in our portfolio. As part of our strategy of increasing our commercial business and commercial real estate loan portfolios, we established a commercial loan department in 2007 and we currently have four commercial business loan officers and six commercial real estate loan officers. During the past five years, our

total loan portfolio has decreased substantially, from \$1.56 billion at December 31, 2008 to \$1.11 billion at June 30, 2013. This decrease reflects a decline in loan demand, a shift in consumer preference for fixed-rate, one- to four-family residential mortgage loans (which we generally do

not retain in our portfolio), and our efforts to control overall growth to maintain strong capital ratios and comply with regulatory directives. There has also been a change in the mix of our portfolio, as one- to four-family residential mortgage loans have decreased from \$788.2 million, or 50.5% of the portfolio at December 31, 2008, to \$425.7 million, or 38.5% of the portfolio at June 30, 2013. During the same period, multi-family residential and commercial real estate loans have increased from \$567.9 million, or 36.4% of the portfolio, to \$589.7 million, or 53.3% of the portfolio. Multi-family and commercial real estate loans comprised 73.5% and 66.9% of total loans originated for investment during the six months ended June 30, 2013 and the year ended December 31, 2012, respectively, while one- to four-family residential mortgage loans comprised 14.4% and 17.2% of total originations during these same periods. We intend to continue our emphasis on multi-family residential and commercial real estate lending. However, we would consider purchasing adjustable-rate one- to four-family mortgage loans from Waterstone Mortgage Corporation in the future in the event changes in interest rates or consumer preferences enable Waterstone Mortgage Corporation to originate such loans.

Continued emphasis on mortgage banking operations. Waterstone Mortgage Corporation has become a significant originator of fixed-rate, one-to-four family mortgage loans, with total originations of \$978.3 million, \$1.75 billion and \$1.03 billion during the six months ended June 30, 2013 and the years ended December 31, 2012 and 2011, respectively. Waterstone Mortgage Corporation originates loans in the retail market, and sells most of its loan production to Wells Fargo, Freddie Mac, Chase and Fannie Mae. It has also been approved to sell loans to Ginnie Mae. Subject to market conditions and particularly changes in the interest rate environment, we intend to continue to grow our mortgage banking business, which has been a significant source of our net income in recent periods. Such growth may occur through geographic expansion, online direct consumer origination, or both.

Enhance core earnings by increasing lower cost transaction and savings accounts. Demand, checking and money market accounts are a lower cost source of funds than time deposits, and we have made a concerted effort to increase lower-cost transaction deposit accounts and reduce time deposits. Our ratio of time deposits to total deposits has decreased from 87.1% at December 31, 2008 to 76.4% at June 30, 2013. We plan to continue to aggressively market our core transaction accounts and savings accounts, emphasizing our high quality service and competitive pricing of these products. In the past two years we have also introduced remote deposit capture, internet banking and mobile banking.

Stockholder-focused management of capital. We recognize that a strong capital position is essential to achieving our long-term objective of building stockholder value. Following the offering, at the minimum of the offering range, our pro forma tier 1 leverage ratio is expected to be 16.80% and our pro forma total risk-based capital ratio is expected to be 26.50%, which are well in excess of the amounts required to be considered “well capitalized.” This capital position will support our future growth and expansion, and will give us flexibility to pursue other capital management strategies to enhance stockholder value. In particular, New Waterstone intends to commence paying a regular quarterly dividend following completion of the conversion. See “Our Dividend Policy” for a discussion of our expected dividend policy following the completion of the conversion.

Disciplined expansion through organic growth coupled with opportunistic acquisitions. Since we became a public company in 2005, we have successfully pursued a strategy of organic growth by continuing to leverage our existing community banking franchise and expanding our mortgage banking operations. Since our initial public offering, we have opened three additional branches in the Milwaukee area. In October 2013, we opened a loan production office in Maple Grove, Minnesota, a part of the greater Minneapolis-St. Paul metropolitan area. We have also received regulatory approval to open a new full-service banking office in Brookfield, Wisconsin, which we expect to open in January 2014. Subject to regulatory approval, we plan to open two offices in



each of 2014 through 2016 (including our new Brookfield office), all in our local market area, and we may also seek to open additional loan production offices or full service branches in other markets. Waterstone Mortgage Corporation now has locations in 14 states and does business nationally. While organic growth has been our primary focus, we will also consider acquisition opportunities that we believe would enhance our franchise and yield financial benefits for our stockholders.

#### 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). We recognize 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;

Comparing the estimated current book value to that of updated sales values experienced on similar real estate owned;

Comparing the estimated current book value to that of updated values seen on more current appraisals of similar properties; and

Comparing 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 us).

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 primarily real estate, declines in value by a substantial amount or if unemployment in our primary market area increases significantly, our

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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.** Waterstone-Federal 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 (“GAAP”), 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, we 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 positive cumulative net income for the latest three-year period, the payment of federal income taxes potentially available for subsequent carry back in future periods and improvement in our asset quality metrics as well as in general economic conditions.

Positions taken in our 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.

Management believes our tax policies and practices are critical because the determination of the tax provision and current and deferred tax assets and liabilities have a material impact on our net income and the carrying value of our assets.

**Fair Value Measurements.** We determine the fair value of our 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 our 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 June 30, 2013 and at December 31, 2012

**Total Assets.** Total assets decreased by \$28.2 million, or 1.7%, to \$1.63 billion at June 30, 2013 from \$1.66 billion at December 31, 2012. The decrease in total assets reflects decreases in loans receivable of \$26.8 million, cash and cash equivalents of \$17.1 million and real estate owned of \$6.0 million. Cash and cash equivalents, in addition to funds received from the repayment of loans held in portfolio and from escrow deposits, were used to fund deposit outflows of \$46.5 million and an increase in available for sale securities of \$11.2 million during the six months ended June 30, 2013.

**Cash and Cash Equivalents.** Cash and cash equivalents decreased \$17.1 million, or 23.9%, to \$54.4 million at June 30, 2013, from \$71.5 million at December 31, 2012. Despite the decrease, the overall level of cash and cash equivalents continues to reflect our plan to maintain higher than usual 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 increased by \$11.2 million, or 5.5%, to \$216.3 million at June 30, 2013 from \$205.0 million at December 31, 2012. This increase reflects a \$22.2 million increase in municipal securities and a \$6.3 million increase in government-sponsored enterprise bonds, partially offset by a \$10.8 million decrease in mortgage-backed securities and a \$6.8 million decrease in government-sponsored enterprise issued collateralized mortgage obligations. During the six months ended June 30, 2013, the proceeds from principal repayments on mortgage-related securities were reinvested in municipal securities that we considered to provide a better risk-adjusted return. As of June 30, 2013, we held two municipal securities with a total fair value of \$189,000 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 which was charged against earnings. There was no additional other than temporary impairment recorded during the six months ended June 30, 2013.

**Loans Held for Sale.** Loans held for sale decreased \$1.6 million, or 1.2%, to \$132.0 million at June 30, 2013 from \$133.6 million at December 31, 2012. During the six months ended June 30, 2013, \$978.3 million in residential loans were originated for sale. During the same period, sales of loans held for sale totaled \$979.9 million.

**Loans Receivable.** Loans receivable held for investment decreased \$26.8 million, or 2.4%, to \$1.11 billion at June 30, 2013 from \$1.13 billion at December 31, 2012. The decrease in total loans receivable was primarily attributable to a \$35.1 million decrease in one- to four-family loans, partially offset by a \$5.5 million increase in commercial real estate loans and a \$4.4 million increase in multi-family real estate loans. The decrease in one- to four-family loans reflects a decline in loan demand for adjustable-rate real estate mortgage loans as borrowers continue to prefer long-term fixed-rate loans that we do not generally retain in our portfolio. As a result of the low interest rate environment with respect to long-term fixed-rate real estate mortgage loans, we continued to experience a shift in the composition of loans originated for portfolio during 2013 and 2012 from one- to four-family residential adjustable-rate loans to residential real estate loans collateralized by multi-family properties and commercial real estate, as these categories of borrowers displayed relatively stable levels of demand for our existing products. During the six months ended June 30, 2013, \$8.4 million of loans were transferred to real estate owned and \$6.2 million were charged-off, net of recoveries.

Allowance for Loan Losses. The allowance for loan losses decreased \$3.3 million, or 10.6%, to \$27.8 million at June 30, 2013 from \$31.0 million at December 31, 2012. The \$3.3 million decrease in the allowance for loan losses during the six months ended June 30, 2013 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, 2012, 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 June 30, 2013, the allowance for loan losses to total loans

receivable was 2.51% and was equal to 52.14% of non-performing loans, compared to 2.74% and 41.58%, respectively, at December 31, 2012. The \$3.3 million decrease in the allowance for loan losses during the six months ended June 30, 2013 was primarily the result of a \$3.0 million decrease in the allowance for loan losses related to the one- to four-family loan category. The decrease related to this category resulted from the charge-off of specific reserves, a stabilization or improvement of key loan quality metrics, as well as a decrease in the overall balance of loans outstanding. 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 84.7% of the total allowance for loan losses at June 30, 2013 and 89.1% at December 31, 2012.

**Real Estate Owned.** Total real estate owned decreased \$6.0 million, or 16.7%, to \$30.0 million at June 30, 2013 from \$36.0 million at December 31, 2012. During the six months ended June 30, 2013, \$8.4 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 \$950,000 during the six months ended June 30, 2013. During the same period, sales of real estate owned totaled \$13.5 million.

**Prepaid Expenses and Other Assets.** Prepaid expenses and other assets increased by \$7.3 million, or 26.8%, to \$34.5 million at June 30, 2013 from \$27.2 million at December 31, 2012. The increase was primarily due to an increase in mortgage banking derivative assets, as well as an increase in the mortgage servicing rights intangible asset that relates to an increase in loans sold on a servicing retained basis. The increase in prepaid expenses and other assets was partially offset by a decrease in net deferred tax assets.

**Deposits.** Total deposits decreased \$46.5 million, or 5.0%, to \$893.0 million at June 30, 2013 from \$939.5 million at December 31, 2012. 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 \$55.0 million, or 7.5%, to \$681.9 million at June 30, 2013 from \$736.9 million at December 31, 2012. The decrease in time deposits was partially offset by an increase in money market and savings deposits and demand deposits. Total money market and savings deposits increased \$1.2 million, or 1.0%, to \$119.6 million at June 30, 2013 from \$118.5 million at December 31, 2012. Total demand deposits increased \$7.4 million, or 8.8%, to \$91.5 million at June 30, 2013 from \$84.1 million at December 31, 2012.

**Borrowings.** Total borrowings increased \$10.2 million, or 2.1%, to \$490.0 million at June 30, 2013 from \$479.9 million at December 31, 2012. The increase in borrowings relates to an increase in the use of short-term repurchase agreements to finance loans held for sale. The balance of these lines of credit increased by \$10.2 million to \$56.0 million at June 30, 2013, from \$45.9 million at December 31, 2012.

**Advance Payments by Borrowers for Taxes.** Advance payments by borrowers for taxes increased \$13.9 million to \$15.6 million at June 30, 2013 from \$1.7 million at December 31, 2012. The increase was the result of payments received from borrowers for their real estate taxes and is seasonally normal, as balances increase during the course of the calendar year until real estate tax obligations are paid out in the fourth quarter.

**Other Liabilities.** Other liabilities decreased \$12.4 million, or 33.3%, to \$24.9 million at June 30, 2013 from \$37.4 million at December 31, 2012. The decrease resulted primarily from a seasonal decrease in outstanding escrow checks. We receive payments from borrowers for their real estate taxes during the course of the calendar year until real estate tax obligations are paid out in the fourth quarter. These amounts remain classified as other liabilities until settled. The decrease related to escrow checks was partially offset by an increase in amounts due to third parties

related to the origination of loans held for sale.

Shareholders' Equity. Shareholders' equity increased by \$6.7 million, or 3.3%, to \$209.3 million at June 30, 2013 from \$202.6 million at December 31, 2012. The increase in shareholders' equity was primarily due to \$9.6 million in net income for the six months ended June 30, 2013 and a \$428,000 decrease in unearned ESOP shares. Partially offsetting the increases was a \$3.2 million decrease in accumulated other comprehensive income.

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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 and short-term borrowings, as well as 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, which was largely 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 Held for Sale.** Loans held for sale, all of which were held by Waterstone Mortgage Corporation, increased \$45.3 million, or 51.3%, to \$133.6 million at December 31, 2012 from \$88.3 million at December 31, 2011. Loans originated for sale in the secondary market totaled \$1.75 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 \$1.03 billion.

**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 multi-family loans. The decrease in one- to four-family loans reflects a decline in loan demand for adjustable-rate real estate mortgage loans as borrowers continue to prefer long-term fixed-rate loans that we do not generally retain in our portfolio. During the year ended December 31, 2012, \$22.3 million of 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 multi-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 loan categories. Increases in the allowance for loan losses related to the one- to four-family and commercial real estate loan 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 loans 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% at 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 net 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 bank lines of credit to finance loans held for sale. The outstanding balance of these lines of credit 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 at and 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 June 30, 2013		2013		Six Months Ended June 30, 2012		2012		Average Yield/Rate (7)	
	Yield/Rate	Average Balance	Interest	Average Yield/Rate (7)	Average Balance	Interest	Average Yield/Rate (7)			
(Dollars in Thousands)										
Interest-earning assets:										
Loans receivable and held for sale	4.90	% \$1,239,390	\$30,075 (1)	4.89	% \$1,284,612	\$32,892 (1)	5.13			%
Mortgage related securities (2)	2.01	139,283	856	1.24	121,915	1,784	2.93			
Debt securities, federal funds sold and short-term investments (2) (3)	2.06	156,906	1,153	1.48	196,728	1,255	1.28			
Total interest-earning assets	4.36	1,535,579	32,084	4.21	1,603,255	35,931	4.49			
Noninterest-earning assets		98,053			96,856					
Total assets		\$1,633,632			\$1,700,111					
Interest-bearing liabilities:										
Demand accounts	0.03	\$44,959	6	0.03	\$30,445	13	0.09			
Money market and savings accounts	0.11	124,436	73	0.12	117,419	163	0.28			
Certificates of deposit	0.73	709,969	2,740	0.78	857,086	5,690	1.33			
Total interest-bearing deposits	0.60	879,364	2,819	0.65	1,004,950	5,866	1.17			
Borrowings	3.84	485,229	9,198	3.82	464,855	9,010	3.89			
Total interest-bearing liabilities	1.78	1,364,593	12,017	1.78	1,469,805	14,876	2.03			
Non-interest-bearing liabilities:										

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Non-interest bearing deposits	41,694			39,411	
Other non-interest bearing liabilities	19,772			15,447	
Total non-interest bearing liabilities	61,466			54,858	
Total liabilities	1,426,059			1,524,663	
Equity	207,573			175,448	
Total liabilities and equity	\$1,633,632			\$1,700,111	
Net interest income		\$20,067			\$21,055
Net interest rate spread (4)			2.43	%	2.46
Net interest-earning assets (5)	\$170,986			\$133,450	
Net interest margin (6)			2.64	%	2.63
Average interest-earning assets to average interest-bearing liabilities			112.53	%	109.08

(footnotes on following page)

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	Years Ended December 31,								
	2012			2011			2010		
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
	(Dollars in Thousands)								
Interest-earning assets:									
Loans receivable and held for sale	\$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 (2)	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 investments (2) (3)	180,117	2,251	1.25	239,400	3,261	1.36	206,066	3,412	1.66
Total interest-earning assets	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	\$39,818	24	0.06	\$38,328	30	0.08	\$37,852	37	0.10
Money market and savings accounts	127,261	273	0.21	120,231	369	0.31	110,479	495	0.45
Certificates of deposit	809,446	9,180	1.13	925,209	14,890	1.61	1,007,304	20,457	2.03
Total interest-bearing deposits	976,525	9,477	0.97	1,083,768	15,289	1.41	1,155,635	20,989	1.82
Borrowings	475,114	18,424	3.87	446,401	17,547	3.93	481,808	19,280	4.00
Total interest-bearing liabilities	1,451,639	27,901	1.92	1,530,169	32,836	2.15	1,637,443	40,269	2.46
Non-interest-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 liabilities	1,504,956			1,582,185			1,681,172		
Equity	184,787			167,053			169,932		
	\$1,689,743			\$1,749,238			\$1,851,104		

Total liabilities and equity					
Net interest income	\$41,945		\$46,516		\$49,664
Net interest rate spread (4)	2.45 %		2.67 %		2.67
Net interest-earning assets (5)	\$142,882		\$117,398		\$116,446
Net interest margin (6)	2.62 %		2.82 %		2.83
Average interest-earning assets to average interest-bearing liabilities	109.84%		107.67%		107.

(1) Includes net deferred loan fee amortization income of \$339,000, \$296,000, \$657,000, \$636,000 and \$739,000 for the six months ended June 30, 2013 and 2012 and the years ended December 31, 2012, 2011 and 2010, respectively.

(2) Average balance of available for sale securities is based on amortized historical cost.

(3) Interest income from tax exempt securities is not significant to total interest income, therefore, interest and yield on interest-earning assets are not stated on a tax equivalent basis. The average balance of tax exempt securities totaled \$43.8 million, \$20.7 million, \$19.1 million, \$27.6 million and \$24.0 million for the six months ended June 30, 2013 and 2012 and the years ended December 31, 2012, 2011 and 2010, respectively.

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

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

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

(7) Annualized.

## 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.

	Six Months Ended June 30, 2013 vs. 2012			Years Ended December 31, 2012 vs. 2011			Years Ended December 31, 2011 vs. 2010		
	Increase (Decrease) due to Volume	Rate	Net	Increase (Decrease) due to Volume	Rate	Net	Increase (Decrease) due to Volume	Rate	Net
(In Thousands)									
Interest income:									
Loans receivable and held for sale (1)	\$(1,206 )	\$(1,611 )	\$(2,817 )	\$(1,990 )	\$(5,962 )	\$(7,952 )	\$(6,985 )	\$(1,907 )	\$(8,892 )
Mortgage related securities	225	(1,153 )	(928 )	1,399	(1,943 )	(544 )	(615 )	(923 )	(1,538 )
Other interest-earning assets	(280 )	178	(102 )	(752 )	(258 )	(1,010 )	505	(656 )	(151 )
Total interest-earning assets	(1,261 )	(2,586 )	(3,847 )	(1,343 )	(8,163 )	(9,506 )	(7,095 )	(3,486 )	(10,581 )
Interest expense:									
Demand accounts	5	(11 )	(6 )	1	(7 )	(6 )	—	(7 )	(7 )
Money market and savings accounts	9	(99 )	(90 )	21	(117 )	(96 )	41	(167 )	(126 )
Certificates of deposit	(863 )	(2,088 )	(2,951 )	(1,692 )	(4,018 )	(5,710 )	(1,570 )	(3,997 )	(5,567 )
Total interest-bearing deposits	(849 )	(2,198 )	(3,047 )	(1,670 )	(4,142 )	(5,812 )	(1,529 )	(4,171 )	(5,700 )
Borrowings	353	(165 )	188	1,154	(277 )	877	(1,384 )	(349 )	(1,733 )
Total interest-bearing liabilities	(496 )	(2,363 )	(2,859 )	(516 )	(4,419 )	(4,935 )	(2,913 )	(4,520 )	(7,433 )
Net change in net interest income	\$(765 )	\$(223 )	\$(988 )	\$(827 )	\$(3,744 )	\$(4,571 )	\$(4,182 )	\$1,034	\$(3,148 )

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(1) Includes net deferred loan fee amortization income of \$339,000, \$296,000, \$657,000, \$636,000 and \$739,000 for the six months ended June 30, 2013 and 2012 and the years ended December 31, 2012, 2011 and 2010, respectively.

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## Segment Review

As described in the notes to consolidated financial statements, we have two reportable segments: community banking and mortgage banking. Community banking, which is conducted through WaterStone Bank, consists of lending and deposit taking (as well as other banking-related products and services) to consumers and businesses and the support to deliver, fund, and manage such banking services. Mortgage banking, which is conducted through Waterstone Mortgage Corporation, consists of originating residential mortgage loans for sale in the secondary market.

Our community banking segment generates the significant majority of our consolidated net interest income and requires the significant majority of our provision for loan losses. Our mortgage banking segment generates the significant majority of our non-interest income and a majority of our non-interest expense. Accordingly, we have provided below a discussion of the material results of operations of Waterstone Mortgage Corporation on a separate basis for the six months ended June 30, 2013 and 2012 and for the years end December 31, 2012, 2011 and 2010, which focuses on a discussion of non-interest income and non-interest expense. We have also provided a discussion of the consolidated operations of Waterstone-Federal, which includes the consolidated operations of WaterStone Bank and Waterstone Mortgage Corporation, for the same periods.

For further information, see note 15 of the notes to the unaudited consolidated financial statements at June 30, 2013 and December 31, 2012 and for the six months ended June 30, 2013 and 2012 and note 20 of the notes to the audited consolidated financial statements at December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011 and 2010.

### Comparison of Mortgage Banking Segment Operations for the Six Months Ended June 30, 2013 and 2012

Mortgage banking revenues increased \$11.6 million, or 31.4%, to \$48.4 million for the six months ended June 30, 2013 compared to \$36.8 million during the six months ended June 30, 2012. The \$11.6 million increase in mortgage banking revenues was attributable to an increase in loan origination volume. The increase in loan origination volumes 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 in the secondary market totaled \$978.3 million during the six months ended June 30, 2013, which represents a \$211.2 million, or 27.5%, increase in originations from \$767.1 million for the six months ended June 30, 2012.

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 six months ended June 30, 2013, the growth in loan origination volume resulted in a shift towards conventional loans and loans made for the purpose of a refinancing. Loans originated for the purchase of a residential property comprised 57.9% of total originations during the six months ended June 30, 2013, compared to 60.2% during the six months ended June 30, 2012. The mix of loan type also changed slightly with conventional loans and governmental loans comprising 68.0% and 32.0% of all loan originations, respectively, during the six months ended June 30, 2013. During the six months ended June 30, 2012 conventional loans and governmental loans comprised 64.6% and 35.4% of all loan originations, respectively.

Due primarily to an increase in loan origination activity, total compensation, payroll taxes and other benefits at our mortgage banking subsidiary increased \$9.9 million, or 50.2%, to \$29.7 million for the six months ended June 30, 2013 compared to \$19.8 million during the six months ended June 30, 2012. The increase in compensation at our mortgage banking subsidiary correlates to the increase in mortgage banking transaction volume due to the



commission-based compensation structure in place for our mortgage banking loan officers. The increase in compensation also reflects an increase in staffing levels necessary to support the increase in loan origination volumes.

## Comparison of Consolidated Operating Results for the Six Months Ended June 30, 2013 and 2012

General. Net income for the six months ended June 30, 2013 totaled \$9.6 million, or \$0.31 for basic income per share and \$0.30 for diluted income per share, compared to net income of \$8.4 million, or \$0.27 for both basic and diluted income per share, for the six months ended June 30, 2012. The six months ended June 30, 2013 generated an annualized return on average assets of 1.18% and an annualized return on average equity of 9.28%, compared to an annualized return on average assets of 0.99% and an annualized return on average equity of 9.61% for the comparable period in 2012. Income before income taxes increased \$7.1 million to \$15.5 million during the six months ended June 30, 2013, compared to \$8.5 million during the six months ended June 30, 2012. The pre-tax results of operations for the six months ended June 30, 2013 as compared to the six months ended June 30, 2012 reflect a \$1.4 million increase in pre-tax income from our mortgage banking operations, a \$4.1 million decrease in real estate owned expense and a \$2.1 million decrease in the provision for loan losses, partially offset by a \$988,000 decrease in net interest income.

Income taxes totaled \$6.0 million during the six months ended June 30, 2013, compared to \$71,000 during the six months ended June 30, 2012. The provision for loan losses totaled \$3.0 million during the six months ended June 30, 2013, compared to \$5.1 million for the six months ended June 30, 2012.

Total Interest Income. Total interest income decreased \$3.8 million, or 10.7%, to \$32.1 million during the six months ended June 30, 2013 from \$35.9 million during the six months ended June 30, 2012.

Interest income on loans decreased \$2.8 million, or 8.6%, to \$30.1 million during the six months ended June 30, 2013 from \$32.9 million during the six months ended June 30, 2012. The decrease in interest income was primarily due to a 24 basis point decrease in the average yield on loans to 4.89% for the six months ended June 30, 2013 from 5.13% for the six months ended June 30, 2012. The decrease in interest income on loans also reflects a \$45.2 million, or 3.5%, decrease in the average balance of loans outstanding to \$1.24 billion during the six months ended June 30, 2013 from \$1.28 billion during the six months ended June 30, 2012.

Interest income from mortgage-related securities decreased \$928,000, or 52.0%, to \$856,000 during the six months ended June 30, 2013 from \$1.8 million during the six months ended June 30, 2012. The decrease in interest income was due to a 169 basis point decrease in the average yield on mortgage-related securities to 1.24% for the six months ended June 30, 2013 from 2.93% for the six months ended June 30, 2012. The decrease in average yield was partially offset by a \$17.4 million, or 14.3%, increase in the average balance of mortgage-related securities to \$139.3 million for the six months ended June 30, 2013 from \$121.9 million during the six months ended June 30, 2012. The decrease in average yield resulted from a general turnover of the investment security portfolio in which cash flows from higher yielding securities were reinvested in lower yielding securities due to the low interest rate environment.

Interest income from other interest earning assets (comprised of debt securities, federal funds sold and short-term investments) decreased \$102,000, or 8.1%, to \$1.2 million for the six months ended June 30, 2013 compared to \$1.3 million for the six months ended June 30, 2012. Interest income decreased due to a decrease of \$39.8 million, or 20.2%, in the average balance of other earning assets to \$156.9 million during the six months ended June 30, 2013 from \$196.7 million during the six months ended June 30, 2012. The decrease in interest income from other earning assets due to a decrease in average balance was partially offset by a 20 basis point increase in the average yield on other earning assets to 1.48% for the six months ended June 30, 2013 from 1.28% for the six months ended June 30, 2012. The average balance of higher yielding, tax-exempt municipal securities increased to \$43.8 million for the six months ended June 30, 2013 from \$20.7 million for the six months ended June 30, 2012, accounting for the increase in the average yield for the period.

Total Interest Expense. Total interest expense decreased by \$2.9 million, or 19.2%, to \$12.0 million during the six months ended June 30, 2013 from \$14.9 million during the six months ended June 30, 2012. 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 25 basis points to 1.78% for the six months ended June 30, 2013 from 2.03% for the six months ended June 30, 2012. Total average interest bearing deposits and borrowings outstanding decreased \$105.2 million, or 7.2%, to \$1.36 billion for the six months ended June 30, 2013 compared to an average balance of \$1.47 billion for the six months ended June 30, 2012.

Interest expense on deposits decreased \$3.0 million, or 52.0%, to \$2.8 million during the six months ended June 30, 2013 from \$5.9 million during the six months ended June 30, 2012. The decrease in interest expense on deposits was primarily due to a decrease in the average cost of deposits of 52 basis points to 0.65% for the six months ended June 30, 2013 compared to 1.17% for the six months ended June 30, 2012. The decrease in the cost of deposits reflects the current low interest rate environment due to the Federal Reserve's low short-term interest rate policy. These rates are typically used by financial institutions in pricing deposit products. 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 \$125.6 million, or 12.5%, in the average balance of interest bearing deposits to \$879.4 million during the six months ended June 30, 2013 from \$1.0 billion during the six months ended June 30, 2012. The decrease in average interest-bearing deposits was 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 \$188,000, or 2.1%, to \$9.2 million during the six months ended June 30, 2013 from \$9.0 million during the six months ended June 30, 2012. The increase primarily resulted from a \$20.4 million, or 4.4%, increase in average borrowings outstanding to \$485.2 million during the six months ended June 30, 2013 from \$464.9 million during the six months ended June 30, 2012. The increased use of borrowings as a funding source during the six months ended June 30, 2013 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 increase in average balance was partially offset by a 7 basis point decrease in the average cost of borrowings to 3.82% during the six months ended June 30, 2013 compared to 3.89% during the six months ended June 30, 2012.

Net Interest Income. Net interest income decreased by \$988,000, or 4.7%, to \$20.1 million during the six months ended June 30, 2013 as compared to \$21.1 million during the six months ended June 30, 2012. The decrease in net interest income resulted primarily from a \$67.7 million, or 4.2%, decrease in the average balance of interest earning assets to \$1.54 billion during the six months ended June 30, 2013 from \$1.60 billion during the six months ended June 30, 2012, together with a \$105.2 million, or 7.2%, decrease in the average balance of interest-bearing liabilities to \$1.36 billion from \$1.47 billion. The 28 basis point decrease in the average yield on interest earning assets was largely offset by a 25 basis point decrease in the average cost of interest-bearing liabilities.

Provision for Loan Losses. Our provision for loan losses decreased \$2.1 million, or 42.0%, to \$3.0 million during the six months ended June 30, 2013, from \$5.1 million during the six months ended June 30, 2012. 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 rates. While the provision for loan losses has decreased from the prior year, it remains at historically elevated levels. These levels remain elevated 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.

Net charge-offs totaled \$6.2 million, or an annualized 1.01% of average loans for the six months ended June 30, 2013, compared to \$4.9 million, or an annualized 0.76% of average loans for the six months ended June 30, 2012. Of the \$6.2 million in net charge-offs during the six months ended June 30, 2013, substantially all related to loans secured by one- to four-family residential loans. Weakness in the residential real estate market continues and the risk of loss on loans secured by residential real estate remains at an elevated level.

Noninterest Income. Total noninterest income increased \$11.5 million, or 30.0%, to \$49.7 million during the six months ended June 30, 2013 from \$38.3 million during the six months ended June 30, 2012.

Mortgage banking income increased \$10.7 million, or 29.2%, to \$47.4 million for the six months ended June 30, 2013, compared to \$36.7 million during the six months ended June 30, 2012. See “Comparison of Mortgage Banking Segment Operations for the Six Months Ended June 30, 2013 and 2012” above, for a discussion of the increase in mortgage banking income.

Noninterest Expense. Total noninterest expense increased \$5.6 million, or 12.2%, to \$51.3 million during the six months ended June 30, 2013 from \$45.8 million during the six months ended June 30, 2012. The increase was primarily attributable to increased compensation, partially offset by a decrease in real estate owned expense.

Compensation, payroll taxes and other employee benefit expense increased \$10.8 million, or 42.2%, to \$36.4 million during the six months ended June 30, 2013 compared to \$25.6 million during the six months ended June 30, 2012.

Due primarily to an increase in loan origination activity, total compensation, payroll taxes and other benefits at our mortgage banking subsidiary increased \$9.9 million, or 50.2%, to \$29.7 million for the six months ended June 30, 2013 compared to \$19.8 million during the six months ended June 30, 2012. The increase in compensation at our mortgage banking subsidiary correlates to the increase in mortgage banking transaction volume due to the commission-based compensation structure in place for our mortgage banking loan officers. The increase in compensation also reflects an increase in staffing levels necessary to support the increase in loan origination volumes.

Real estate owned expense decreased \$4.1 million, or 96.4%, to \$153,000 during the six months ended June 30, 2013 from \$4.3 million during the six months ended June 30, 2012. The decrease in real estate owned expense results from a decrease in net property management expense and a decrease in net losses recognized upon the sale or write-downs of properties. During the six months ended June 30, 2013, net operating expense, which primarily relates to property taxes, maintenance and management fees, net of rental income, decreased \$648,000, or 40.4%, to \$955,000 from \$1.6 million during the six months ended June 30, 2012. 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 average balance of properties owned. The average balance of real estate owned totaled \$32.4 million for the six months ended June 30, 2013 compared to \$54.9 million for the six months ended June 30, 2012. Sales and write-downs of real estate owned resulted in a net gain of \$802,000 during the six months ended June 30, 2013. During the six months ended June 30, 2012, sales and write downs of real estate owned resulted in a net loss of \$2.7 million.

Income Taxes. Income tax expense increased from \$71,000 during the six months ended June 30, 2012 to \$6.0 million for the six months ended June 30, 2013. During the third quarter of 2008, we established a valuation allowance against our net deferred tax assets. That valuation allowance effectively resulted in no income tax expense being recognized during the six months ended June 30, 2012 other than state income taxes for states in which separate company returns are filed. During the fourth quarter of 2012, we released the valuation allowance against our net deferred tax assets. Therefore, income tax expense is recognized during the six months ended June 30, 2013 at an effective rate of 38.5% of pretax book income. In addition, our income before income taxes increased from \$8.5 million during the six months ended June 30, 2012 to \$15.5 million during the six months ended June 30, 2013.

As of June 30, 2013, net deferred tax assets totaled \$15.3 million, which, in the judgment of management, will more-likely-than-not be fully realized. The largest components of the deferred tax assets are associated with the allowance for loan losses and basis adjustments on real estate owned. We are largely relying on earnings generated in the current year and forecasted earnings in future years in making the determination that we will more-likely-than-not realize our deferred tax assets.

#### Comparison of Mortgage Banking Segment Operations for the Years Ended December 31, 2012 and 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 \$1.75 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 \$1.03 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. 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 due in large part to historically low interest rates on these products.

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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 refinancing; however, margins increased for all loan types and loan purposes, 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. 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.

Due primarily to an increase in loan origination activity, total compensation, payroll taxes and other employee benefits at Waterstone Mortgage Corporation 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 Waterstone Mortgage Corporation resulted from the increase in mortgage banking income and the higher compensation due Waterstone Mortgage Corporation's banking loan officers under our commission-based compensation structure. In addition, operational costs of Waterstone Mortgage Corporation increased \$4.6 million to \$10.5 million for the year ended December 31, 2012, compared to \$5.9 million during the year ended December 31, 2011, related to the expansion of Waterstone Mortgage Corporation.

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

General. Net income for the year ended December 31, 2012 totaled \$39.4 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, 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.

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 increase was the result of a decrease in the average yield on interest-earning assets and a decrease in the average balance of interest-earning 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

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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 was 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 average cost of 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 reflected an increased use of external lines of credit by our mortgage banking segment to fund loan originations to be sold in the secondary market. The average cost of borrowings decreased six 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 rates 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 historically 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. See “Comparison of Mortgage Banking Segment Operations for the Years Ended December 31, 2012 and 2011” above, for a discussion of the increase in mortgage banking income.

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 from \$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 reflected the increase in mortgage banking income and higher compensation due to our mortgage banking loan officers under our 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 net operating costs related to the properties. 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, among other items, 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 an

increase in operational costs related to the expansion of our mortgage banking operations of \$4.6 million 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, positive cumulative net income for the most recent three years, 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 Internal Revenue Service 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 and 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.

#### Comparison of Mortgage Banking Segment Operations for the Years Ended December 31, 2011 and 2010

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 changes 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.

Compensation, payroll taxes and other employee benefits increased by \$3.5 million, or 14.7%, to \$26.9 million for the year ended December 31, 2011 from \$23.5 million during the year ended December 31, 2010. The increase is primarily the result of an increase in commissions paid to loan originators by Waterstone Mortgage Corporation and reflects the increase in mortgage banking income.

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Comparison of Consolidated 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.

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



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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

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average cost of 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. See "Business of WaterStone Bank—Asset Quality" and "—Allowance for Loan Losses" for an analysis of charge-offs, nonperforming assets, specific reserves and additional provisions.

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. See "Comparison of Mortgage Banking Segment Operations for the Years Ended December 31, 2011 and 2010" above, for a discussion of the increase in

mortgage banking income.

Noninterest Expense. Total noninterest expense increased \$10.0 million, or 15.4%, 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.

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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 reflected 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 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. 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.

#### 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 adjustable rate loans, including adjustable 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 our investment portfolio; and (iii) whenever possible, lengthening the terms of our deposits and our borrowings from the Federal Home Loan Bank of Chicago. 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 simulations use projected repricing of assets and liabilities at June 30, 2013 and 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 rates decrease and the average expected lives of our assets tend to lengthen more than the expected average lives of our liabilities, which would most likely have a negative impact on net interest income and earnings.

Percentage Increase in  
Estimated Net Annual  
Interest Income  
Over 12 Months  
As of June 30, 2013

300 basis point gradual rise in rates	3.16%
200 basis point gradual rise in rates	2.26%
100 basis point gradual rise in rates	1.47%
Unchanged rate scenario	0.43%
100 basis point gradual decline in rates (1)	(1.02)%

Percentage Increase (Decrease) in  
Estimated Net Annual  
Interest Income  
Over 12 Months  
As of December 31, 2012

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 (4.37%)  
(1)

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

WaterStone Bank's Asset/Liability policy limits projected changes in net average annual interest income to a maximum decline of 25% for various levels of interest rate changes measured over a 12-month period when compared to a flat rate scenario. In addition, projected changes in the economic value of equity are limited to a maximum decline of 35% for interest rate movements of up to 300 basis points when compared to a flat rate scenario. These limits are re-evaluated on a periodic basis and may be modified, as appropriate. At June 30, 2013, a 100 basis point gradual increase in interest rates had the effect of increasing estimated net interest income by 1.47%

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while a 100 basis point decrease in rates had the effect of decreasing estimated net interest income by 1.02%. At June 30, 2013, a 100 basis point gradual increase in interest rates had the effect of reducing the economic value of equity by 7.57% while a 100 basis point decrease in rates had the effect of increasing the economic value of equity by 6.46%. 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.

### Liquidity and Capital Resources

We maintain liquid assets at levels we consider adequate to meet our liquidity needs. Our liquidity ratio averaged 3.9%, 5.1% and 6.2% for the six months ended June 30, 2013 and 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 WDFI, 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 June 30, 2013 were 9.61% and 17.50% respectively, and 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 June 30, 2013 and December 31, 2012 and 2011, \$54.4million, \$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. At June 30, 2013, we held, 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.

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During the six months ended June 30, 2013 and the years ended December 31, 2012, 2011 and 2010, loan repayments net of loan originations generated positive cash flows of \$12.2 million, \$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 adjustable-rate residential real estate mortgage loans combined with our tightened underwriting standards given the current economic conditions. Cash received from the calls, maturities and principal repayments of debt and mortgage related securities totaled \$24.0 million, \$109.2 million, \$93.5 million and \$87.8 million for the six months ended June 30, 2013 and the years ended December 31, 2012, 2011 and 2010, respectively. We purchased \$42.7 million, \$134.9 million, \$100.0 million and \$101.7 million in debt and mortgage related securities classified as available for sale during the six months ended June 30, 2013 and the years ended December 31, 2012, 2011 and 2010, respectively. We sold \$921,000, \$30.1 million, \$3.3 million and \$20.7 million in available for sale debt and mortgage related securities during the six months ended June 30, 2013 and 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 \$46.5 million for the six months ended June 30, 2013, while 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 June 30, 2013, 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 puttable at the option of the Federal Home Loan Bank of Chicago. The weighted average rate on these advances was 3.88% as of June 30, 2013.

At June 30, 2013, we had outstanding commitments to originate loans of \$22.5 million and unfunded commitments under construction loans, lines of credit and standby letters of credit of \$32.7 million. At June 30, 2013, certificates of deposit scheduled to mature in less than one year totaled \$463.3 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 June 30, 2013, WaterStone Bank exceeded all regulatory capital requirements, and is considered “well capitalized” under regulatory guidelines. See “Supervision and Regulation—Capital Requirements,” and note 8 of the notes to the unaudited consolidated financial statements at June 30, 2013 and December 31, 2012 and for the six months ended June 30, 2013 and 2012.

The net proceeds from the stock offering will significantly increase our liquidity and capital resources. Over time, the initial level of liquidity will be reduced as net proceeds from the stock offering are used for general corporate purposes, including the funding of loans. Our financial condition and results of operations will be enhanced by the net

proceeds from the stock offering, resulting in increased net interest-earning assets and net interest income. However, due to the increase in equity resulting from the net proceeds from the stock offering, our return on equity will be adversely affected following the stock offering.

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## 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 (1)	\$202,593	\$202,593	\$—	\$—	\$—
Certificates of deposit (1)	736,920	454,561	251,822	30,517	20
Bank lines of credit (1)	45,888	45,888	—	—	—
Federal Home Loan Bank advances (2)	350,000	—	—	285,000	65,000
Repurchase agreements (1) (3)	84,000	—	—	84,000	—
Operating leases (4)	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) Excludes interest.

(2) 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.

(3) The repurchase agreements are callable on a quarterly basis.

(4) Represents non-cancellable operating leases for offices and equipment.

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

## 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	—	—	—

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Standby letters of credit	736	736	—	—	—
Total Other Commitments	\$55,669	\$55,669	\$—	\$—	\$—

- (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 one year.

As of December 31, 2012 and 2011, we serviced \$635.8 million and \$29.9 million of loans, respectively, primarily for Fannie Mae and Freddie Mac. At the time of the closing of these loans we owned the loans and subsequently sold them, and, with respect to loans sold to Fannie Mae and Freddie Mac, we provided normal and customary representations and warranties, including representations and warranties related to underwriting standards. At December 31, 2012 and 2011, substantially all of the loans serviced for others were performing in accordance with their contractual terms, and management believes that we have no material repurchase obligations associated with these loans.

#### Future Accounting Pronouncements

New accounting policies we adopted during 2012 are discussed in Note 1, "Summary of Significant Accounting Policies," to the audited consolidated financial statements at December 31, 2012 and 2011 and for the years ended December 31, 2012, 2011 and 2010, respectively. To the extent the adoption of new accounting standards materially affects our 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.

#### Impact of Inflation and Changing Prices

The financial statements and accompanying notes of Waterstone-Federal have been prepared in accordance with accounting principles generally accepted in the United States. 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 the effects of inflation.

## BUSINESS OF NEW WATERSTONE AND WATERSTONE-FEDERAL

### New Waterstone

New Waterstone is a Maryland corporation that was organized in June 2013. Upon completion of the conversion, New Waterstone will become the holding company of WaterStone Bank and will succeed to all of the business and operations of Waterstone-Federal and each of Waterstone-Federal and Lamplighter Financial, MHC will cease to exist.

Initially following the completion of the conversion, New Waterstone will have a total of \$6.0 million in cash and securities held by Waterstone-Federal and Lamplighter Financial, MHC as of June 30, 2013, and the net proceeds it retains from the offering, part of which will be used to make a loan to the WaterStone Bank Employee Stock Ownership Plan. New Waterstone will have no significant liabilities. New Waterstone intends to use the support staff and offices of WaterStone Bank and will pay WaterStone Bank for these services. If New Waterstone expands or changes its business in the future, it may hire its own employees.

New Waterstone intends to invest the net proceeds of the offering as discussed under “How We Intend to Use the Proceeds From the Offering.” In the future, we may pursue other business activities, including mergers and acquisitions, investment alternatives and diversification of operations. There are, however, no current understandings or agreements for these activities.

### Waterstone-Federal

Waterstone-Federal is a federally chartered corporation that owns all of the outstanding shares of common stock of WaterStone Bank. At June 30, 2013, Waterstone-Federal had consolidated assets of \$1.63 billion, deposits of \$893.0 million and stockholders' equity of \$209.3 million.

WaterStone Bank became the wholly-owned subsidiary of Waterstone-Federal's Wisconsin predecessor, Wauwatosa Holdings, Inc. in 2005, when WaterStone Bank reorganized into the two-tier mutual holding company structure and Wauwatosa Holdings, Inc. concurrently sold 10,117,125 shares of its common stock to the public, representing 30% of its then-outstanding shares, at \$10.00 per share. An additional 23,050,183 shares, or 68.35% of the outstanding shares, were issued to Lamplighter Financial, MHC, and 556,442 shares, or 1.65% of the outstanding shares were issued to the WaterStone Bank Fund of the Waukesha County Community Foundation, Inc.

Waterstone-Federal's executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226 and the telephone number is (414) 761-1000. Its website address is [www.wsbonline.com](http://www.wsbonline.com). Information on this website is not and should not be considered a part of this proxy statement/prospectus.

## BUSINESS OF WATERSTONE BANK

WaterStone Bank is a community bank that has served the banking needs of its customers since 1921. WaterStone Bank also has an active mortgage banking subsidiary, Waterstone Mortgage Corporation, which had 71 offices in 14 states as of June 30, 2013.

WaterStone Bank conducts its community banking business from eight banking offices and nine automated teller machines located in Milwaukee, Washington and Waukesha Counties, Wisconsin, as well as a loan production office in Maple Grove, Minnesota. WaterStone Bank's principal lending activity is originating one- to four-family and

multi-family residential real estate loans for retention in its portfolio. At June 30, 2013, such loans comprised 38.5% and 46.9%, respectively, of WaterStone Bank's loan 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 funds its loan production primarily with retail deposits and Federal Home Loan Bank advances. Our deposits consist primarily of certificates of deposit, which accounted for 76.4% of total deposits at June 30, 2013. Our 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 WDFI and the Federal Deposit Insurance Corporation.

WaterStone Bank's executive offices are located at 11200 West Plank Court, Wauwatosa, Wisconsin 53226, and its telephone number is (414) 761-1000. Its website address is [www.wsbonline.com](http://www.wsbonline.com). Information on this website is not and should not be considered to be a part of this proxy statement/prospectus.

WaterStone Bank's mortgage banking operations are conducted through its wholly-owned subsidiary, Waterstone Mortgage Corporation. Waterstone Mortgage Corporation originates single-family residential real estate loans for sale in the secondary market. Waterstone Mortgage Corporation utilizes lines of credit provided by WaterStone Bank as a primary source of funds, and also utilizes lines of credit with other financial institutions as needed. During the six months ended June 30, 2013, and the years ended December 31, 2012 and 2011, Waterstone Mortgage Corporation originated \$978.3 million, \$1.75 billion and \$1.03 billion, respectively, in mortgage loans held for sale.

#### Market Area

WaterStone Bank. WaterStone Bank's market area is broadly defined as the Milwaukee, Wisconsin metropolitan market, which is geographically located in the southeast corner of the state. WaterStone Bank's 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, 2013 (the latest date for which information was publicly available), 47.8% of deposits in the State of Wisconsin were located in the seven-county metropolitan Milwaukee market.

WaterStone Bank's 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, in October 2013 we opened a loan production office in Maple Grove, Minnesota, which is expected to have a primary lending market area of the Minneapolis-St. Paul, Minnesota metropolitan market.

From 2000 to 2010, our market area experienced population increases from a high of 13.1% in Jefferson County to a low of 0.8% in Milwaukee County, compared to 6.0% for Wisconsin and 9.7% for the United States as a whole. Projections indicate that through 2017, the population will continue to increase in all market area counties ranging from a low of 1.0% in Racine County to a high of 4.6% in Washington County compared to projected increases of 3.2% and 4.9% in Wisconsin and the United States, respectively. Consistent with trends in population, our market areas experienced increases in households from 2000 to 2010 at rates ranging from a high of 17.7% in Washington County to a low of 1.6% in Milwaukee County, compared to increases in households of 9.4% in Wisconsin and 10.7% in the United States. Through 2017, households are projected to increase at rates ranging from 1.6% in Racine County to 4.7% in Washington County, compared to 3.6% in Wisconsin and 5.1% in the United States.

The 2000 median household income levels of six of our seven community banking market area counties were above the state and national levels, with Milwaukee County being the only county with per capita income levels below state and national levels. The 2000 median household income levels ranged from a low of \$38,100 in Milwaukee County to a high of \$62,839 in Waukesha County. From 2000 to 2010, median household income increased in all area counties by percentages ranging from a low of 6.8% in Milwaukee County to a high of 19.4% in Walworth County. In 2010, median household income ranged from a low of \$40,702 in Milwaukee County to a high of \$73,703

in Ozaukee County, with all but Milwaukee County having higher median income levels than both the state and national levels of \$50,395 and \$50,046, respectively. By 2017, the projected increases in median household income are expected to range from 3.0% in Walworth County to 22.8% in Milwaukee County, with median household income levels in Jefferson, Milwaukee and Walworth Counties increasing less than both state and national levels and the four other counties increasing more than the increases at the state and national levels. The

2017 projected median household income levels ranged from \$50,001 in Milwaukee County to \$81,501 in Waukesha County, compared to \$57,220 in Wisconsin and \$56,895 in the United States.

In 2008, four of the seven counties in the market area had lower unemployment rates than that of the State of Wisconsin as a whole while the remaining three counties had unemployment rates lower than that of the United States as a whole. Through 2010, unemployment rates increased in the United States and in Milwaukee County but decreased in Wisconsin as a whole and in six of the market area counties. In 2011, unemployment rates continued to decrease in all market areas. In 2012, unemployment rates decreased in all market area counties and ranged from a high of 8.5% in both Milwaukee and Racine Counties to a low of 5.7% in Ozaukee County compared to 6.9% in Wisconsin and 8.1% in the United States. Through June 2013, unemployment increased in all but the national level, ranging from a low of 5.8% in Ozaukee County to a high of 8.9% in Racine County with the state and national levels at 7.0% and 7.8%, respectively.

According to the 2010 Census, the median home values in the community banking market area ranged from a low of \$159,800 in Milwaukee County to a high of \$253,700 in Ozaukee County, with an average of \$204,414 for the seven market area counties. Median 2010 home values for the State of Wisconsin and for the United States were \$166,700 and \$179,900, respectively.

In March 2013, Corelogic reported that the foreclosure rate in the metropolitan Milwaukee area, Milwaukee, Waukesha, Ozaukee and Washington Counties, fell to 1.97% of mortgaged homes in January 2013 from 2.69% in January 2012. Similarly, the foreclosure rate for the State of Wisconsin fell to 1.68% in January 2013 from 2.30% in January 2012. For the United States, the foreclosure rate dropped to 2.8% in 2013 compared to 3.5% in 2012. In a related trend, year-over-year increases in home sales in market area counties are reported. According to Metro MLS Inc. data released by the Greater Milwaukee Association of Realtors, home sales in June 2013 increased by 7.8% compared to June 2012 for the metropolitan area defined as Milwaukee, Waukesha, Ozaukee, and Washington counties.

Waterstone Mortgage Corporation. As of June 30, 2013, Waterstone Mortgage Corporation had 21 offices in Wisconsin, 11 offices in Pennsylvania, 10 offices in Minnesota, nine offices in Florida, five offices in Indiana, three offices in Ohio, two offices in each of Arizona, Idaho, Illinois and Iowa, and one office in each of Colorado, Maryland, North Carolina and South Carolina.

## Competition

WaterStone Bank. WaterStone Bank faces 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, 2013, based on the Federal Deposit Insurance Corporation’s annual Summary of Deposits Report, we had the eighth largest market share in our metropolitan statistical area out of 56 financial institutions in our metropolitan statistical area, representing 1.6% 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.

Waterstone Mortgage Corporation. Waterstone Mortgage Corporation faces competition for originating loans both directly within the markets in which it operates and from entities that provide services throughout the United States through internet services. Waterstone Mortgage Corporation's competition comes principally from

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other mortgage banking firms, as well as from commercial banks, savings institutions and credit unions. In 2012, the Business Journal of Milwaukee ranked Waterstone Mortgage Corporation as southeastern Wisconsin's largest mortgage lender for the fourth year in a row.

#### 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 totaled \$425.7 million, or 38.5% of our total loan portfolio at June 30, 2013. Multi-family residential real estate loans totaled \$518.7 million, or 46.9% of our total loan portfolio at June 30, 2013. We also offer construction and land loans, commercial real estate loans, home equity lines of credit and commercial loans. At June 30, 2013, commercial real estate loans, construction and land loans, home equity loans and commercial business loans totaled \$71.0 million, \$37.0 million, \$35.4 million and \$19.0 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 June 30, 2013		2012		2011		At December 31, 2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	
(Dollars in Thousands)										
Mortgage loans:										
Residential real estate:										
One- to four-family	\$425,693	38.46 %	\$460,821	40.65 %	\$496,736	40.83 %	\$582,026	44.56 %	\$679,657	
Multi-family	518,745	46.86	514,363	45.37	552,240	45.39	542,602	41.53	536,731	
Home equity	35,382	3.20	36,494	3.22	38,599	3.17	46,149	3.53	57,589	
Construction and land	36,981	3.34	33,818	2.98	39,528	3.25	53,961	4.13	61,953	
Commercial real estate	70,960	6.41	65,495	5.78	65,434	5.38	51,733	3.96	48,948	
Commercial loans	19,020	1.72	22,549	1.99	24,018	1.97	29,812	2.28	34,513	
Consumer	134	0.01	132	0.01	109	0.01	154	0.01	619	
Total loans	1,106,915	100.00 %	1,133,672	100.00 %	1,216,664	100.00 %	1,306,437	100.00 %	1,420,010	
Allowance for loan losses	(27,767 )		(31,043 )		(32,430 )		(29,175 )		(28,494 )	
Loans, net	\$1,079,148		\$1,102,629		\$1,184,234		\$1,277,262		\$1,391,516	

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.

Due during the years ended December 31,	One- to four-family		Multi-family		Home Equity		Construction and Land	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in Thousands)								
2013	\$ 29,228	5.66 %	\$ 45,816	5.84 %	\$ 10,857	4.34 %	\$ 16,102	5.25 %
2014	33,138	5.79 %	42,475	5.70 %	5,776	4.01 %	2,519	4.80 %
2015	5,244	5.10 %	22,679	5.06 %	8,397	4.07 %	3,898	4.54 %
2016 and 2017	9,187	4.77 %	38,570	4.23 %	5,494	5.26 %	978	3.16 %
2018 through 2022	75,887	5.48 %	291,260	5.04 %	5,914	4.65 %	8,318	4.43 %
2023 through 2027	11,188	6.06 %	10,336	5.22 %	—	—	639	4.92 %
2028 and thereafter	296,949	5.09 %	63,227	5.47 %	56	4.50 %	1,364	4.77 %
Total	\$ 460,821	5.26 %	\$ 514,363	5.16 %	\$ 36,494	4.41 %	\$ 33,818	4.85 %

Due during the years ended December 31,	Commercial Real Estate		Commercial Business		Consumer		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in Thousands)								
2013	\$ 5,481	6.17 %	\$ 12,385	3.46 %	\$ 94	5.60 %	\$ 119,963	5.36 %
2014	6,556	5.77 %	1,514	6.11 %	14	6.03 %	91,992	5.61 %
2015	9,513	5.85 %	3,173	5.28 %	—	—	52,904	5.02 %
2016 and 2017	20,235	5.33 %	2,129	5.30 %	24	3.00 %	76,617	4.67 %
2018 through 2022	18,112	5.50 %	2,888	4.80 %	—	—	402,379	5.12 %
2023 through 2027	38	6.75 %	—	—	—	—	22,201	5.64 %
2028 and thereafter	5,560	5.94 %	460	5.50 %	—	—	367,616	5.17 %
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 (In Thousands)	Total
Mortgage loans			
Real estate loans:			
One- to four-family	\$ 28,504	\$ 403,089	\$ 431,593
Multi-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 \$425.7 million, or 38.5% of total loans at June 30, 2013. One- to four-family residential mortgage loans originated for investment during the six months ended June 30, 2013 totaled \$9.2 million, or 14.4% of all loans originated for investment, and such 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 annual rate adjustments of 200 basis points, with a lifetime maximum adjustment of 600 basis points. Our adjustable-rate mortgage loans typically amortize over terms of up to 30 years, and are indexed to the 12-month LIBOR rate. 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 loans.

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 loan 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 \$181,000 and the largest outstanding balance was \$3.9 million on June 30, 2013. The average two- to four-family first mortgage loan balance was \$144,000 on June 30, 2013, and the largest outstanding



balance on that date was \$5.0 million, which is a consolidation loan that is collateralized by 29 properties.

**Multi-family Real Estate Loans.** Multi-family loans totaled \$518.7 million, or 46.9% of total loans at June 30, 2013. Multi-family loans originated during the six months ended June 30, 2013 totaled \$37.2 million or 58.4% of all loans originated for investment, and such 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 multi-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. Multi-family real estate loans are offered with interest rates that are fixed for periods of up to five years or are adjustable 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 whether to make a multi-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, multi-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.

A multi-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 multi-family mortgage loan balance was \$726,000 on June 30, 2013, with the largest outstanding balance at \$8.0 million. At June 30, 2013, our largest exposure to one borrower or to a related group of borrowers was \$20.4 million. The largest loan in the group is a mortgage loan with an outstanding balance at June 30, 2013 of \$8.0 million.

Loans secured by multi-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 multi-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 June 30, 2013, outstanding home equity loans and equity lines of credit totaled \$35.4 million, or 3.2% of total loans outstanding. At June 30, 2013, the unadvanced portion of home equity lines of credit totaled \$16.4 million. Home equity loans and lines originated during the six months ended June 30, 2013 totaled \$2.9 million, or 4.5% of all loans originated for investment, and such loans 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 \$40,000 at June 30, 2013, with the largest outstanding balance at that date of \$881,000.

**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 June 30, 2013, construction and land loans totaled \$37.0 million, or 3.3% of total loans. Construction and land loans originated during the six months ended June

30, 2013 totaled \$2.4 million, or 3.8% of all loans originated for investment, and such loans originated during the year ended December 31, 2012 totaled \$2.7 million, or 2.7% of all loans originated for investment. At June 30, 2013, the unadvanced portion of these construction loans totaled \$4.9 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

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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 \$1.2 million on June 30, 2013, with the largest outstanding balance at \$5.0 million. The average outstanding land loan balance was \$370,000 on June 30, 2013, 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 percentage of completion method.

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, with a value that is insufficient to ensure full repayment of the loan.

Commercial Real Estate Loans. Commercial real estate loans totaled \$71.0 million at June 30, 2013, or 6.4% 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 six months ended June 30, 2013 totaled \$9.6 million, or 15.1% of all loans originated for investment, and such 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 adjustable 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 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 annual 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 June 30, 2013 was \$476,000, and the largest outstanding balance at that date was \$3.3 million.

Commercial Loans. Commercial loans totaled \$19.0 million at June 30, 2013, or 1.7% of total loans, and are made up of loans secured by accounts receivable, inventory, equipment and real estate. Commercial loans originated during the six months ended June 30, 2013 totaled \$2.4 million, or 3.8% of all loans originated, and such loans originated during the year ended December 31, 2012 totaled \$9.9 million, or 9.9% of all loans originated. In an effort to increase our commercial loan portfolio, we established a commercial loan department in 2007 and we currently have four commercial business loan officers.

Our commercial 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 adjustable interest rates. At June 30, 2013, the unadvanced portion of working capital lines of credit totaled \$10.3 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 adjustable. Commercial business loans are generally adjustable 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 June 30, 2013 was \$146,000 and the largest outstanding balance on that date was \$1.7 million.

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

	As of or for the Six Months Ended June 30,		As of or for the Year Ended December 31,		
	2013	2012	2012	2011	2010
	(In Thousands)				
Total gross loans receivable and held for sale at beginning of period	\$1,267,285	\$1,304,947	\$1,304,947	\$1,443,824	\$1,516,800
Real estate loans originated for investment:					
Residential:					
One- to four-family	9,187	10,352	17,088	13,651	11,390
Multi-family	37,190	22,930	51,816	60,367	69,602
Home equity	2,882	1,915	3,112	4,328	5,528
Construction and land	2,372	238	2,695	3,487	8,355
Commercial real estate	9,637	10,900	14,572	25,398	5,813
Total real estate loans originated for investment	61,268	46,335	89,283	107,231	100,688
Consumer loans originated for investment	—	35	35	—	76
Commercial loans originated for investment	2,401	3,013	9,857	9,366	11,204
Total loans originated for investment	63,669	49,383	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	(75,861 )	(82,992 )	(165,683 )	(200,544 )	(169,093 )

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Transfers to real estate owned	(8,404 )	(11,002 )	(22,282 )	(28,259 )	(41,781 )
Loan principal charged-off, net of recoveries	(6,161 )	(4,872 )	(9,687 )	(18,821 )	(25,151 )
Net activity in loans held for investment	(26,757 )	(49,483 )	(82,991 )	(131,027 )	(124,057 )
Loans originated for sale	978,327	767,092	1,749,426	1,027,346	1,084,362
Loans sold	(979,895 )	(732,886 )	(1,704,097)	(1,035,196)	(1,033,281)
Net activity in loans held for sale	(1,568 )	34,206	45,329	(7,850 )	51,081
Total gross loans receivable and held for sale at end of period	\$1,238,960	\$1,289,670	\$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 these 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 June 30, 2013, WaterStone Bank was servicing \$2.4 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 us 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 us 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 us 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 us exceeding \$10,000,000 must be reviewed 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 a specific date by which delinquent payments must be made or by which they must 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 the specified time period 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.



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

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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 the time a loan is placed on non-accrual status, 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 June 30,		At December 31,				
	2013	2012	2011	2010	2009	2008	
	(Dollars in Thousands)						
Non-accrual loans:							
Residential							
One- to four-family	\$36,664	\$46,467	\$55,609	\$56,759	\$45,988	\$42,182	
Multi-family	9,259	23,205	13,680	20,587	16,683	35,787	
Home equity	1,328	1,578	1,334	712	1,159	2,015	
Construction and land	5,199	2,215	6,946	3,013	6,269	18,271	
Commercial real estate	272	668	514	1,577	2,773	9,325	
Commercial	511	511	135	1,530	2,441	150	
Consumer	20	24	—	—	—	—	
Total non-accrual loans	53,253	74,668	78,218	84,178	75,313	107,730	
Real estate owned							
One- to four-family	15,458	17,353	27,449	28,142	27,016	16,720	
Multi-family	7,514	9,890	16,231	14,903	8,824	6,057	
Construction and land	5,200	7,029	8,796	9,926	10,458	1,094	
Commercial real estate	1,811	1,702	4,194	4,781	4,631	782	
Total real estate owned	29,983	35,974	56,670	57,752	50,929	24,653	
Total non-performing assets	\$83,236	\$110,642	\$134,888	\$141,930	\$126,242	\$132,383	
Total accruing troubled debt restructurings	\$26,177	\$16,011	\$24,589	\$33,592	\$42,730	\$2,409	
Total non-accrual loans to total loans, net	4.81	% 6.59	% 6.43	% 6.44	% 5.30	% 6.91	%
Total non-accrual loans and accruing troubled debt restructurings to total loans receivable	7.18	% 8.00	% 8.45	% 9.01	% 8.31	% 7.06	%
Total non-accrual loans to total assets	3.26	% 4.50	% 4.57	% 4.65	% 4.03	% 5.71	%

Total non-performing assets to total assets	5.10	%	6.66	%	7.88	%	7.85	%	6.76	%	7.02	%
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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.

The following table sets forth activity in our non-accrual loans for the periods indicated.

	At or for the Six Months Ended June 30,			At or for the Year Ended December 31,			
	2013	2012	2012	2011	2010	2009	2008
	(In Thousands)						
Balance at beginning of period	\$74,668	\$78,218	\$78,218	\$84,178	\$75,313	\$107,730	\$80,350
Additions	17,608	31,340	44,617	59,703	87,349	76,435	106,286
Transfers to real estate owned	(8,404 )	(11,002 )	(22,282 )	(28,259 )	(41,781 )	(54,072 )	(32,946 )
Charge-offs	(6,766 )	(3,443 )	(8,379 )	(14,138 )	(24,395 )	(23,541 )	(24,517 )
Returned to accrual status	(20,000 )	(8,043 )	(8,194 )	(12,021 )	(7,936 )	(17,601 )	(13,600 )
Principal paydowns and other	(3,853 )	(2,318 )	(9,312 )	(11,245 )	(4,372 )	(13,638 )	(7,843 )
Balance at end of period	\$53,253	\$84,752	\$74,668	\$78,218	\$84,178	\$75,313	\$107,730

Total non-accrual loans decreased by \$21.4 million, or 28.7%, to \$53.3 million as of June 30, 2013 compared to \$74.7 million as of December 31, 2012. The ratio of non-accrual loans to total loans receivable was 4.81% at June 30, 2013 compared to 6.59% at December 31, 2012. During the six months ended June 30, 2013, \$20.0 million of loans were returned to accrual status, \$8.4 million were transferred to real estate owned (net of charge-offs), \$6.8 million in loan principal was charged off and \$3.9 million in principal payments were received. Offsetting this activity, \$17.6 million of loans were placed on non-accrual status during the six months ended June 30, 2013.

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 \$83.0 million, or 6.8%, during the year ended December 31, 2012. A total of \$44.6 million of loans were placed on non-accrual status during the year ended December 31, 2012. During the year ended December 31, 2012, we transferred \$22.3 million of loans to real estate owned (net of charge-offs), \$8.2 million of loans returned to accrual status, we charged-off \$8.4 million of loans and we experienced \$6.7 million in principal pay downs.

Of the \$53.3 million in total non-accrual loans as of June 30, 2013, \$37.9 million of 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 \$7.5 million in partial charge-offs has been recorded with respect to these loans as of June 30, 2013. 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 \$4.1 million have been recorded as of June 30,

2013. The remaining \$15.4 million of non-accrual loans were reviewed on an aggregate basis and \$4.0 million in general valuation allowance was deemed necessary related to those loans as of June 30, 2013. The \$4.0 million in general valuation allowance is based upon a migration analysis performed with respect to similar non-accrual loans in prior periods.

Our largest non-accrual relationship at March 31, 2013 consisted of five loans with an aggregate principal balance of \$10.9 million, all of which are collateralized by multi-family residential real estate. The loans are part of a troubled debt restructuring and are performing in accordance with their modified terms. During the quarter ended June 30, 2013, this borrower met the remaining requirements necessary to return the loans to accrual status. These loans remain classified as troubled debt restructurings as of June 30, 2013.

Our largest non-accrual loan as of June 30, 2013 was collateralized by multi-family residential real estate located in southeastern Wisconsin. This loan had a principal balance of \$3.9 million at June 30, 2013 and a specific

valuation allowance of \$135,000. As of June 30, 2013, the loan was performing in accordance with modified terms under a troubled debt restructuring. Our second largest non-accrual loan as of June 30, 2013 was collateralized by a single-family residence located in Montana. This loan had a principal balance of \$2.2 million at June 30, 2013 and a specific valuation allowance of \$1.0 million. Our third and fourth largest non-accrual loans relate to one borrower. The loans, which are collateralized by improved land held for development and a single-family residence, had a principal balance of \$1.8 million and \$1.6 million, respectively, as of June 30, 2013. We have established a valuation allowance of \$954,000 with respect to these two loans. Our remaining largest non-accrual loan as of June 30, 2013 was collateralized by improved land held for development, located in southeastern Wisconsin. This loan had a principal balance of \$1.4 million at June 30, 2013, which is net of life-to-date charge offs of \$1.5 million. Together, these five largest non-accrual loans comprised 20.3% of total non-accrual loans at June 30, 2013.

For the six months ended June 30, 2013 and the year ended December 31, 2012, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was \$1.6 million and \$4.4 million, respectively. We recognized \$1.0 million and \$2.9 million of interest income on such loans during the six months ended June 30, 2013 and the year ended December 31, 2012, respectively.

There were no accruing loans past due 90 days or more during the six months ended June 30, 2013 or during the years ended December 31, 2012, 2011 or 2010.

Troubled Debt Restructurings. The following table summarizes troubled debt restructurings.

	At June 30, 2013	2012	2011	At December 31, 2010	2009	2008
	(In Thousands)					
Troubled debt restructurings						
Substandard	\$24,853	\$48,449	\$47,220	\$15,769	\$18,003	\$2,409
Watch	22,247	11,172	8,192	20,703	34,082	—
Total troubled debt restructurings	\$47,100	\$59,621	\$55,412	\$36,472	\$52,085	\$2,409

Troubled debt restructurings totaled \$47.1 million at June 30, 2013, compared to \$59.6 million at December 31, 2012 and \$55.4 million at December 31, 2011. At June 30, 2013, \$39.9 million of troubled debt restructurings, or 84.8%, were performing in accordance with their restructured terms. 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 the notes to the consolidated 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.

We do not participate in government-sponsored troubled debt restructuring programs. Our troubled debt restructurings are short-term modifications. Typical initial restructured terms include six to twelve months of principal forbearance, a reduction in interest rate or both. Restructured terms do not include a reduction of the outstanding principal balance unless mandated by a bankruptcy court. Troubled debt restructuring terms may be renewed or further modified at the end of the initial term for an additional period if performance has been acceptable and the short-term borrower difficulty persists.

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

	At June 30, 2013		At December 31,			
	Non-Accruing	Accruing	2012		2011	
			Non-Accruing	Accruing	Non-Accruing	Accruing
	(In Thousands)					
Troubled Debt Restructurings:						
Residential						
One- to four-family	\$ 12,842	\$ 8,420	\$ 21,847	\$ 9,921	\$ 26,773	\$ 8,293
Multi-family	5,962	16,340	20,030	3,917	2,453	14,845
Home equity	1,007	—	986	—	1,024	43
Construction and land	840	1,408	79	2,173	79	1,408
Commercial real estate	272	—	668	—	452	—
Commercial	—	9	—	—	42	—
Total	\$ 20,923	\$ 26,177	\$ 43,610	\$ 16,011	\$ 30,823	\$ 24,589

The following table sets forth activity in our troubled debt restructurings for the periods indicated.

	At or for the Six Months Ended		At or for the Year Ended December 31,			
	June 30, 2013		2012		2011	
	Accrual	Non-Accrual	Accrual	Non-Accrual	Accrual	Non-Accrual
	(In Thousands)					
Balance at beginning of period	\$ 16,011	\$ 43,609	\$ 24,589	\$ 30,823	\$ 33,592	\$ 2,879
Additions	98	620	3,651	24,049	15,066	24,614
Change in accrual status	16,146	(16,146 )	(2,060 )	2,060	(3,764 )	3,764
Charge-offs	(63 )	(1,970 )	(270 )	(1,795 )	(836 )	(191 )
Returned to contractual/market terms	(5,721 )	(2,845 )	(8,773 )	(8,502 )	(18,758 )	(225 )
Transferred to real estate owned	—	(1,625 )	(125 )	(1,009 )	(359 )	—
Principal paydowns and other	(294 )	(720 )	(1,001 )	(2,016 )	(352 )	(18 )
Balance at end of period	\$ 26,177	\$ 20,923	\$ 16,011	\$ 43,610	\$ 24,589	\$ 30,823

For the six months ended June 30, 2013 and the year ended December 31, 2012, gross interest income that would have been recorded had our troubled debt restructurings been current in accordance with their original terms was \$1.5 million and \$3.6 million, respectively. We recognized \$1.2 million and \$2.4 million of interest income on such loans during the six months ended June 30, 2013 and the year ended December 31, 2012, respectively.

If a restructured loan is current in all respects and a minimum of six consecutive restructured payments have been received, it can be considered for return to accrual status. After a restructured loan that is current in all respects reverts to contractual/market terms, if a credit department review indicates no evidence of elevated market risk, the loan is removed from the troubled debt restructuring classification.

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

	At June 30,	At December 31,			
	2013	2012	2011		
	(Dollars in Thousands)				
Loans past due less than 90 days	\$27,049	\$23,092	\$36,798		
Loans past due 90 days or more	33,557	51,358	56,612		
Total loans past due	\$60,606	\$74,450	\$93,410		
Total loans past due to total loans receivable	5.48	% 6.57	% 7.68	%	%

Past due loans decreased by \$13.8 million, or 18.6%, to \$60.6 million at June 30, 2013 from \$74.5 million at December 31, 2012. Loans past due 90 days or more decreased by \$17.8 million, or 34.7%, during the six months ended June 30, 2013 while loans past due less than 90 days increased by \$4.0 million, or 17.1%. The \$17.8 million decrease in loans past due 90 days or more was primarily due to an \$11.0 million lending relationship that was brought current under the terms of a troubled debt restructuring during the three months ended June 30, 2013. The \$4.0 million increase in loans past due less than 90 days or more was primarily attributable to a \$7.4 million increase in loans collateralized by construction and land loans, \$5.0 million of which has been subsequently paid off.

Real Estate Owned. Total real estate owned decreased by \$6.0 million, or 16.7%, to \$30.0 million at June 30, 2013, compared to \$36.0 million at December 31, 2012. During the six months ended June 30, 2013, \$8.4 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 \$950,000 during the six months ended June 30, 2013. During the same period, sales of real estate owned totaled \$13.5 million, resulting in a net gain of \$1.8 million.

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, resulting in a net gain of \$1.4 million.

In an effort to strengthen our oversight of problem assets and minimize overall costs and expenses as well as any loss on the sale of real estate owned, during 2011 we established an internal asset management group and an internal sales group, which also enable our lenders to focus on loan origination instead of foreclosed asset management.

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

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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 us).

We owned 178 properties at June 30, 2013, compared to 223 properties as of December 31, 2012 and 323 properties at December 31, 2011. Habitable real estate owned is 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 WDFI, 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.

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

	At or for the Six Months Ended June 30,		At or for the Year Ended December 31,					
	2013	2012	2012	2011	2010	2009	2008	
	(Dollars in Thousands)							
Balance at beginning of period	\$31,043	\$32,430	\$32,430	\$29,175	\$28,494	\$25,167	\$12,839	
Provision for loan losses	2,960	5,100	8,300	22,077	25,832	26,687	37,629	
Charge-offs:								
Mortgage loans								
One- to four-family	5,686	4,133	6,472	11,553	16,906	13,602	8,397	
Multi-family	732	612	1,108	3,996	3,439	3,304	10,056	
Home equity	524	158	485	634	619	861	394	
Construction and land	95	43	1,668	1,745	2,319	3,957	5,088	
Commercial real estate	134	192	1,182	734	575	910	1,838	
Consumer	—	—	4	10	13	9	4	
Commercial	—	59	59	619	1,470	1,000	—	
Total charge-offs	7,171	5,197	10,978	19,291	25,341	23,643	25,777	
Recoveries:								
Mortgage loans								
One- to four-family	608	252	667	311	127	181	313	
Multi-family	201	11	56	40	55	23	31	
Home equity	70	22	25	7	3	1	1	
Construction and land	51	15	250	69	2	77	125	
Commercial real estate	—	—	—	6	1	—	—	
Consumer	2	—	—	1	1	1	6	
Commercial	3	25	293	35	1	—	—	
Total recoveries	935	325	1,291	469	190	283	476	
Net charge-offs	6,236	4,872	9,687	18,822	25,151	23,360	25,301	
Allowance at end of period	\$27,767	\$32,658	\$31,043	\$32,430	\$29,175	\$28,494	\$25,167	
Ratios:								
Allowance for loan losses to	52.14	% 38.53	% 41.58	% 41.46	% 34.66	% 37.83	% 23.36	%

non-performing loans at end of period														
Allowance for loan losses to loans outstanding at end of period	2.51	%	2.80	%	2.74	%	2.67	%	2.23	%	2.01	%	1.61	%
Net charge-offs to average loans outstanding (annualized)	1.01	%	0.76	%	0.76	%	1.43	%	1.75	%	1.54	%	1.67	%
Current period provision for loan losses to net charge-offs	47.47	%	104.68	%	85.68	%	117.29	%	102.71	%	114.24	%	148.73	%
Net charge-offs to beginning of the period allowance (annualized)	40.51	%	15.02	%	29.87	%	64.51	%	88.27	%	92.82	%	197.06	%

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

	At June 30, 2013			2012			At December 31, 2011		
	Allowance for Loan Losses	% of Loans to Total Loans	% of Category to Total Allowance	Allowance for Loan Losses	% of Loans to Total Loans	% of Category to Total Allowance	Allowance for Loan Losses	% of Loans to Total Loans	% of Category to Total Allowance
(Dollars in Thousands)									
Real Estate:									
Residential									
One- to four-family	\$ 14,856	38.46 %	53.50 %	\$ 17,819	40.65 %	57.40 %	\$ 17,475	40.83 %	53.89 %
Multi-family	6,868	46.86	24.73	7,734	45.37	24.90	8,252	45.39	25.44
Home equity	1,806	3.20	6.50	2,097	3.22	6.76	1,998	3.17	6.16
Construction and land	2,166	3.34	7.80	1,323	2.98	4.26	2,922	3.25	9.01
Commercial real estate	1,274	6.41	4.59	1,259	5.78	4.06	941	5.38	2.90
Commercial	762	1.72	2.75	781	1.99	2.52	814	1.97	2.51
Consumer	35	0.01	0.13	30	0.01	0.10	28	0.01	0.09
Total allowance for loan losses	\$ 27,767	100.00 %	100.00 %	\$ 31,043	100.00 %	100.00 %	\$ 32,430	100.00 %	100.00 %

	2010			2009			2008		
	Allowance for Loan Losses	% of Loans to Total Loans	% of Category to Total Allowance	Allowance for Loan Losses	% of Loans to Total Loans	% of Category to Total Allowance	Allowance for Loan Losses	% of Loans to Total Loans	% of Category to Total Allowance
(Dollars in Thousands)									
Real Estate:									
Residential									
One- to four-family	\$16,150	44.56 %	55.36 %	\$17,875	47.86 %	62.73 %	\$14,218	50.54 %	56.49 %
Multi-family	6,877	41.53	23.57	5,208	37.80	18.28	6,844	32.87	27.20
Home equity	1,196	3.53	4.10	1,642	4.06	5.76	1,027	3.80	4.08
Construction and land	3,252	4.13	11.14	2,635	4.36	9.25	2,137	7.15	8.49
Commercial real estate	671	3.96	2.30	720	3.45	2.53	445	3.54	1.77

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Commercial	1,001	2.28	3.43	371	2.43	1.30	457	2.08	1.82
Consumer	28	0.01	0.10	43	0.04	0.15	39	0.02	0.15
Total allowance for loan losses	\$29,175	100.00%	100.00%	\$28,494	100.00%	100.00%	\$25,167	100.00%	100.00%

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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 June 30, 2013, the allowance for loan losses was \$27.8 million, compared to \$31.0 million at December 31, 2012 and \$32.4 million at December 31, 2011. As of June 30, 2013, the allowance for loan losses to total loans receivable was 2.51% and equal to 52.14% of non-performing loans, compared to 2.74%, and 41.58%, respectively at December 31, 2012 and 2.67% and 41.46%, respectively, at December 31, 2011. The decrease in the allowance for loan losses during the six months ended June 30, 2013 and 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. During each period we experienced a stabilization or improvement in a number of key loan-related loan quality metrics, 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 \$6.2 million, or an annualized 1.01% of average loans for the six months ended June 30, 2013, compared to \$4.9 million, or an annualized 0.76% of average loans for the six months ended June 30, 2012. The increase in net charge-offs was primarily the result of an increase in charge-offs related to loans secured by one- to four-family residential loans, which increased \$1.2 million, or 31.5%, to \$5.1 million for six months ended June 30, 2013, as compared to \$3.9 million for the six months ended June 30, 2012. The increase in net charge-offs reflects \$1.4 million in charge-offs related to one borrower with six loans. The \$1.4 million had been included in specific reserves in prior periods.

The \$3.0 million loan loss provision for the six months ended June 30, 2013 reflects our determination that the allowance for loan losses should total \$27.8 million following the net charge-offs recorded during the period and a review of our loan portfolio and general economic conditions.

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 multi-family residential loans. Net charge-offs related to loans secured by one- to four-family residential loans 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 multi-family residential loans 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 our loan portfolio and general economic conditions.

Our underwriting policies and procedures emphasize 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 sale in the secondary market through WaterStone Mortgage Corporation. During the six months ended June 30, 2013 and the years ended December 31, 2012 and 2011, we originated \$978.3 million, \$1.75 billion and \$1.03 billion, respectively, in mortgage loans held for sale. Proceeds from sales to third parties during the six months ended June 30, 2013 and the years ended December 31, 2012 and 2011 totaled \$1.02 billion, \$1.79 billion and \$1.07 billion, respectively. This activity generated approximately \$48.4 million, \$87.4 million and \$39.8 million in mortgage banking income for the six months ended June 30, 2013 and the years ended December 31, 2012 and 2011, respectively. Driven by an increase in loan origination volume for 2013 and 2012 and higher sales margin during 2012, net income related to this segment totaled \$5.3 million during the six months ended June 30, 2013, and 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 Corporation 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 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. Loans originated for sale in the secondary market totaled \$430.1 million during the three months ended March 31, 2013.

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 refinancing existing loans, however, margins increased for all loan types and loan purpose, compared to the year ended December 31, 2011. Loans originated for the purchase of a residential property, which generally yield a higher margin than loans originated for refinancing existing loans, comprised 57.9% of total originations during the six months ended June 30, 2013, compared to 60.2% of total originations during the six months ended June 30, 2012, and 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 has changed slightly with conventional loans and governmental loans comprising 68.0% and 32.0% of all loan originations, respectively, during the six months ended June 30, 2013, compared to 64.6% and

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35.4% of all loan originations, respectively, during the six months ended June 30, 2012, and 67.3% and 32.7% of all loan originations, respectively, during the year ended December 31, 2012 and 61.6% and 38.4% of all loan originations, respectively, during the year ended December 31, 2011.

Compensation expense associated with our mortgage banking activities increased by \$9.9 million to \$29.7 million from \$19.8 million during the six months ended June 30, 2013 and 2012, respectively, and increased \$23.8 million, or 88.5%, to \$50.7 million for the year ended December 31, 2012 compared to \$26.9 million for the year

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ended December 31, 2011. The increases resulted from increases in commissions earned and administrative compensation as a direct result of increases in origination volumes. Occupancy expense totaled \$2.2 million and \$1.9 million during the six months ended June 30, 2013 and 2012, respectively, and 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 increases resulted from an expansion of the branch network that occurred primarily throughout the year ended December 31, 2011. The year ended December 31, 2012 reflects a full year of expense related to those locations. Other noninterest expense totaled \$7.7 million during the six months ended June 30, 2013, and \$8.0 million during the six months ended June 30, 2012, and 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 increases 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 Nevada. Wauwatosa Investments 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. 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 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 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 six months ended June 30, 2013, municipal securities with a total book value of \$930,000 were sold at a loss of \$9,000. 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 June 30, 2013, our government-sponsored enterprise bond portfolio totaled \$14.3 million, all of which were issued by either Fannie Mae, Freddie Mac or the Federal Home Loan Bank

and were classified as available for sale. The weighted average yield on these securities was 0.77% and the weighted average remaining life was 4.4 years at June 30, 2013. 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 June 30, 2013 was \$172,000 less than the amortized cost of \$14.5 million. A total of \$989,000 of government enterprise bonds are pledged as collateral for borrowings at June 30, 2013.

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.

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 June 30, 2013, mortgage-backed securities totaled \$108.2 million. The mortgage-backed securities portfolio had a weighted average yield of 1.93% and a weighted average remaining life of 3.7 years at June 30, 2013. The estimated fair value of our mortgage-backed securities portfolio at June 30, 2013 was \$535,000 more than the amortized cost of \$107.7 million. Mortgage-backed securities valued at \$76.5 million are pledged as collateral for borrowings at June 30, 2013. 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 June 30, 2013, collateralized mortgage obligations totaled \$22.8 million. At June 30, 2013, 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 2.40% and a weighted average remaining life of 2.3 years at June 30, 2013. The estimated fair value of our collateralized mortgage obligations portfolio at June 30, 2013 was \$329,000 more than the amortized cost of \$22.5 million. Collateralized mortgage obligations valued at \$22.8 million are pledged as collateral for borrowings at June 30, 2013. 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 June 30, 2013 and 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 June 30, 2013, our municipal obligations portfolio totaled \$59.6 million, all of which was classified as available for sale. The weighted average yield on this portfolio was 3.96% at June 30, 2013, with a weighted average remaining life of 10.0 years. The estimated market value of our municipal obligations bond portfolio at June 30, 2013 was \$1.6 million less than the amortized cost of \$61.2 million. During the year ended December 31, 2012, we 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. Our 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 June 30, 2013, these securities had a combined amortized cost of \$215,000 and a combined estimated fair value of \$189,000.

**Other Debt Securities.** As of June 30, 2013, we held a trust preferred security with a fair value of \$5.2 million and amortized cost of \$5.0 million. This security, which yields 10.0% per annum, is callable beginning in the second quarter of 2013 with final maturity in 2068.

**Certificates of Deposit.** At June 30, 2013, we held certificates of deposit with a fair value of \$6.2 million and an amortized cost of \$6.1 million. The weighted average yield on these securities was 0.96% and the weighted average remaining life was 1.6 years at June 30, 2013. 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.

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

	At June 30, 2013		2012		At December 31, 2011		2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)							
Securities available for sale:								
Mortgage-backed securities	\$ 107,683	\$ 108,218	\$ 116,813	\$ 119,056	\$ 33,561	\$ 35,417	\$ 42,607	\$ 44,330
Collateralized mortgage obligations:								
Government-sponsored enterprise issued	22,465	22,794	29,207	29,579	32,650	33,196	38,262	39,277
Private label issued	—	—	—	—	19,475	18,451	26,199	25,447
	14,517	14,345	8,000	8,017	71,210	71,349	57,327	57,698

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Government-sponsored enterprise bonds								
Municipal obligations	61,173	59,568	35,493	37,371	37,644	39,068	31,804	31,120
Other debt securities	5,000	5,168	5,000	5,070	5,000	5,118	5,000	5,294
Certificates of deposit	6,125	6,160	5,880	5,924	3,920	3,920	—	—
Total securities available for sale	\$216,963	\$216,253	\$200,393	\$205,017	\$203,460	\$206,519	\$201,199	\$203,166

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The following table sets forth the amortized cost and estimated fair value of securities as of June 30, 2013 that exceeded 10% of our stockholders' equity as of that date.

	At June 30, 2013	
	Amortized	Fair Value
	Cost	
	(In Thousands)	
Fannie Mae:		
Mortgage-backed securities	\$ 90,175	\$ 90,660
Government-sponsored enterprise bonds	10,005	9,903
	\$ 100,180	\$ 100,563
Freddie Mac:		
Mortgage-backed securities	\$ 36,510	\$ 36,871
Government-sponsored enterprise bonds	1,000	1,000
	\$ 37,510	\$ 37,871

#### Held to Maturity Portfolio

As of and for the six months ended June 30, 2013, 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.

Portfolio Maturities and Yields. The composition and maturities of the securities portfolio at June 30, 2013 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	
	Weighted		Weighted		Weighted		Weighted		Weighted	
	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average	Carrying	Average
	Value	Yield	Value	Yield	Value	Yield	Value	Yield	Value	Yield
	(Dollars in Thousands)									
Securities available for sale:										
Mortgage-backed securities	\$—	—	\$99,622	1.85%	\$4,007	2.03%	\$4,589	3.48%	\$108,218	1.93%
Collateralized mortgage obligations										
Government-sponsored enterprise issued	823	5.02%	21,971	2.30	—	—	—	—	22,794	2.40
Government-sponsored enterprise bonds	—	—	13,854	0.78	491	0.39	—	—	14,345	0.77
Municipal obligations	151	1.75	11,536	4.68	19,374	2.81	28,507	4.50	59,568	3.96
Other debt securities	—	—	—	—	—	—	5,168	10.00	5,168	10.00
Certificates of deposit	2,209	0.79	3,951	1.06	—	—	—	—	6,160	0.96
Total securities available for sale	\$3,183	1.91%	\$150,934	2.00%	\$23,872	2.64%	\$38,264	5.08%	\$216,253	2.63%

## 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 76.4% of total deposits at June 30, 2013, and had a weighted average cost of 0.73% 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 and aggressively seeking lower cost savings, checking and money market accounts are expected to result in decreased reliance on higher cost certificates of deposit.

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. We also provide remote deposit capture, internet banking and mobile banking.

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 June 30, 2013, December 31, 2012 and December 31, 2011, \$681.9 million, \$736.9 million and \$878.7 million, or 76.4%, 78.4% and 83.6%, respectively, of our deposit accounts were certificates of deposit, of which \$463.3 million, \$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.

Deposits decreased by \$46.5 million, or 5.0%, from December 31, 2012 to June 30, 2013. The decrease in deposits was the result of a \$55.0 million decrease in time deposits, partially offset by a \$7.4 million increase in demand deposits. 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, \$100,000 and \$399,000 at June 30, 2013 and 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.



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

	At June 30, 2013			At December 31, 2012					
	Balance	Percent	Weighted Average Rate (Dollars in Thousands)	Balance	Percent	Weighted Average Rate			
Deposit type:									
Demand deposits	\$44,646	5.00	% 0.00	% \$39,767	4.23	% 0.00	%		
NOW accounts	46,849	5.24	0.03	% 44,373	4.72	0.03	%		
Regular savings	59,191	6.63	0.05	% 54,837	5.84	0.10	%		
Money market and savings deposits	60,430	6.77	0.16	% 63,616	6.77	0.15	%		
Total transaction accounts	211,116	23.64	0.06	% 202,593	21.56	0.08	%		
Certificates of deposit	681,891	76.36	0.73	% 736,920	78.44	0.83	%		
Total deposits	\$893,007	100.00	% 0.57	% \$939,513	100.00	% 0.67	%		

	At December 31, 2011			At December 31, 2010					
	Balance	Percent	Weighted Average Rate (Dollars in Thousands)	Balance	Percent	Weighted Average Rate			
Deposit type:									
Demand deposits	\$28,812	2.74	% 0.00	% \$30,030	2.62	% 0.00	%		
NOW accounts	39,645	3.77	0.08	% 37,705	3.29	0.08	%		
Regular savings	45,511	4.33	0.20	% 44,540	3.89	0.22	%		
Money market and savings deposits	58,591	5.57	0.41	% 58,863	5.14	0.48	%		
Total transaction accounts	172,559	16.41	0.21	% 171,138	14.94	0.24	%		
Certificates of deposit	878,733	83.59	1.53	% 974,391	85.06	1.74	%		
Total deposits	\$1,051,292	100.00	% 1.31	% \$1,145,529	100.00	% 1.51	%		

	At December 31, 2009			At December 31, 2008					
	Balance	Percent	Weighted Average Rate (Dollars in Thousands)	Balance	Percent	Weighted Average Rate			
Deposit type:									
Demand deposits	\$24,255	2.08	% 0.00	% \$20,664	1.73	% 0.00	%		
	37,165	3.19	0.08	% 32,770	2.74	0.13	%		

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NOW									
accounts									
Regular									
savings	45,219	3.88	0.48	%	27,029	2.26	0.47	%	
Money market and savings									
deposits	46,809	4.02	0.46	%	73,901	6.18	0.95	%	
Total transaction accounts	153,448	13.17	0.30	%	154,364	12.91	0.57	%	
Certificates of deposit	1,011,442	86.83	2.52	%	1,041,533	87.09	3.85	%	
Total									
deposits	\$1,164,890	100.00	%	2.22	%	\$1,195,897	100.00	%	3.42

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At June 30, 2013, the aggregate balance of certificates of deposit of \$100,000 or more was approximately \$177.8 million. The following table sets forth the maturity of those certificates at June 30, 2013.

Due in:	At June 30, 2013 (In thousands)
Three months or less	\$ 35,605
Over three months through six months	18,603
Over six months through 12 months	68,459
Over 12 months	55,142
Total	\$ 177,809

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

	At December 31,			
	At June 30, 2013	2012	2011	2010
(In thousands)				
Interest Rate:				
Less than 1%	\$ 536,383	\$ 562,186	\$ 177,225	\$ 56,294
1.00% to 1.99%	135,073	162,541	588,989	771,822
2.00% to 2.99%	9,306	10,681	92,330	111,511
3.00% to 3.99%	1,129	1,512	4,929	8,840
4.00% to 4.99%	—	—	14,757	25,060
5.00% to 5.99%	—	—	503	864
Total	\$ 681,891	\$ 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 June 30, 2013.

Interest Rate:	At June 30, 2013 Period to Maturity					Total	Percentage of Total Certificate Accounts
	One Year or Less	Over One Year to Two Years	Over Two Years to Three Years	Over Three Years	(Dollars in thousands)		
Less than 1%	\$ 378,077	\$ 154,798	\$ 3,223	\$ 285	\$ 536,383	78.66 %	
1.00% to 1.99%	83,010	9,464	5,269	37,330	135,073	19.81	
2.00% to 2.99%	1,121	4,087	4,062	36	9,306	1.36	
	1,129	—	—	—	1,129	0.17	

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3.00% to  
3.99%

Total	\$ 463,337	\$ 168,349	\$ 12,554	\$ 37,651	\$ 681,891	100.00 %
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Borrowings. Our borrowings at June 30, 2013 consist of advances from the Federal Home Loan Bank of Chicago, repurchase agreements collateralized by investment securities and \$56.0 million outstanding on two bank lines of credit totaling \$90.0 million 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 Six Months Ended June 30,				At or For the Year Ended December 31,					
	2013		2012		2012		2011		2010	
	(Dollars in Thousands)									
Balance outstanding at end of period	\$490,046		\$479,031		\$479,888		\$461,138		\$456,959	
Weighted average interest rate at the end of period	3.84	%	3.83	%	3.82	%	3.93	%	3.94	%
Maximum amount of borrowings outstanding at any month end during the period	\$490,124		\$479,031		\$491,053		\$465,290		\$506,902	
Average balance outstanding during the period	485,229		464,855		475,114		446,401		481,808	
Weighted average interest rate during the period	3.82	%	3.89	%	3.87	%	3.93	%	4.03	%

#### Legal Proceedings

We and our 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-Federal 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 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 WaterStone Bank office facilities and held WaterStone 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 Waterstone-Federal'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, Colorado 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 Chief Financial Officer, the WaterStone Bank Chief Executive Officer, Chief Financial Officer and Senior Vice President and General Counsel.

Main Street Real Estate Holdings, LLC. Established in 2002, Main Street Real Estate Holdings, LLC was established to acquire and hold WaterStone 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 brokerage activities limited to real estate owned, bank-owned branch office facilities and real estate securing loans.

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## Personnel

As of June 30, 2013, we had approximately 782 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.

## Expense and Tax Allocation Agreements

WaterStone Bank will enter into an agreement with New Waterstone to provide it with certain administrative support services, whereby WaterStone Bank will be compensated at not less than the fair market value of the services provided. In addition, WaterStone Bank and New Waterstone will enter into an agreement to establish a method for allocating and for reimbursing the payment of their consolidated tax liability.

## Properties

WaterStone Bank. WaterStone Bank operates from its corporate center, eight full-service banking offices and a drive-through office, located in Milwaukee, Washington and Waukesha Counties, Wisconsin, and a loan production office in Maple Grove, Minnesota. WaterStone Bank has also received regulatory approval to open a new full-service banking office in Brookfield, Wisconsin, and expects to open that office in January 2014. The net book value of our premises, land, and equipment was \$27.8 million at June 30, 2013.

Waterstone Mortgage Corporation. As of June 30, 2013, Waterstone Mortgage Corporation had 21 offices in Wisconsin, 11 offices in Pennsylvania, 10 offices in Minnesota, nine offices in Florida, five offices in Indiana, three offices in Ohio, two offices in each of Arizona, Idaho, Illinois and Iowa, and one office in each of Colorado, Maryland, North Carolina and South Carolina.

## SUPERVISION AND REGULATION

### General

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, supervision and examination by the WDFI and by the Federal Deposit Insurance Corporation. This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the Federal Deposit Insurance Corporation's deposit insurance fund and depositors, and not for the protection of security holders. WaterStone Bank also is regulated to a lesser extent by the Federal Reserve Board, governing reserves to be maintained against deposits and other matters. WaterStone Bank also is a member of and owns stock in the Federal Home Loan Bank of Chicago, which is one of the 12 regional banks in the Federal Home Loan Bank System.

Under this system of regulation, the regulatory authorities have extensive discretion in connection with their supervisory, enforcement, rulemaking and examination activities and policies, including rules or policies that: establish minimum capital levels; restrict the timing and amount of dividend payments; govern the classification of assets; determine the adequacy of loan loss reserves for regulatory purposes; and establish the timing and amounts of assessments and fees. Moreover, as part of their examination authority, the banking regulators assign numerical

ratings to banks and savings institutions relating to capital, asset quality, management, liquidity, earnings and other factors. These ratings are inherently subjective and the receipt of a less than satisfactory rating in one or more categories may result in enforcement action by the banking regulators against a financial institution. A less than satisfactory rating may also prevent a financial institution, such as WaterStone Bank or its holding company, from obtaining necessary regulatory approvals to access the capital markets, pay dividends, acquire other financial institutions or establish new branches.

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.

As a savings and loan holding company following the conversion, New Waterstone will be required to comply with the rules and regulations of the Federal Reserve Board. It will be required to file certain reports with the Federal Reserve Board and will be subject to examination by and the enforcement authority of the Federal Reserve Board. New Waterstone will also be subject to the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Any change in applicable laws or regulations, whether by the WDFI, the Federal Deposit Insurance Corporation, the Federal Reserve Board or Congress, could have a material adverse impact on the operations and financial performance of New Waterstone, WaterStone Bank and WaterStone Mortgage Corporation.

Set forth below is a brief description of material regulatory requirements that are or will be applicable to WaterStone Bank, Waterstone Mortgage Corporation and New Waterstone. The description is limited to certain material aspects of the statutes and regulations addressed, and is not intended to be a complete description of such statutes and regulations and their effects on WaterStone Bank, Waterstone Mortgage Corporation and New Waterstone.

#### 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 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 Interstate Banking Act, 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 Regulation.** 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 the savings bank's total assets, unless the WDFI authorizes a greater amount. Loans are subject to certain other limitations, including percentage restrictions based on 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. Similarly, the line of credit that WaterStone Bank provides to Waterstone Mortgage Corporation is subject to the approval of the WDFI.

Wisconsin savings banks may make loans and extensions of credit, both direct and indirect, to one borrower in amounts up to 15% of the savings 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 the savings bank's capital, subject to certain conditions. At June 30, 2013, WaterStone Bank did not have any loans which exceeded the "loans-to-one borrower" limitations.

In addition, 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 June 30, 2013, WaterStone Bank maintained 99.4% of its assets in qualified thrift investments and therefore met the qualified thrift lender requirement.

**Federal Law and Regulation.** Federal Deposit Insurance Corporation regulations also govern the equity investments of WaterStone Bank and, notwithstanding Wisconsin law and regulations, Federal Deposit Insurance Corporation 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 Federal Deposit Insurance Corporation regulations, WaterStone Bank must obtain prior Federal Deposit Insurance Corporation 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 Federal Deposit Insurance Corporation will not approve an activity that it determines presents a significant risk to the Federal Deposit Insurance Corporation insurance fund. The current 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 New Waterstone, are restricted by the Federal Reserve Act and regulations issued by the Federal Reserve Board 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 have 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 loan 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, multi-family or other non-residential property, the supervisory limit is 80%;

for loans for the construction of one- to four-family residential 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 residential 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

Under Wisconsin law, WaterStone Bank is permitted to establish deposit accounts and accept deposits. WaterStone Bank's board of directors determines the rate and amount of interest to be paid on or credited to deposit accounts subject to Federal Deposit Insurance Corporation 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 Federal Deposit Insurance Corporation.

**Federal Law and Regulation.** WaterStone Bank is a member of the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation. WaterStone Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation, 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 Federal Deposit Insurance Corporation 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 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 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 have an adverse effect on the operating expenses and results of operations of WaterStone Bank. We cannot predict what deposit insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation 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 Federal Deposit Insurance Corporation. We do not know of any practice, condition or violation that might lead to termination of deposit insurance.

In addition to the Federal Deposit Insurance Corporation 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 June 30, 2013, the annualized FICO assessment was equal to 0.64 basis points of total assets less tangible capital.

#### 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 Federal Deposit Insurance Corporation. 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 June 30, 2013 and December 31, 2012 and 2011, WaterStone Bank's capital to assets ratio, as calculated under Wisconsin law, was 12.10%, 11.15% and 9.31%, respectively.

**Federal Law and Regulation.** Under Federal Deposit Insurance Corporation 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 the Federal Deposit Insurance Corporation determines is not anticipating or experiencing significant growth and is, 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 1 leverage capital to total assets ratio is 3%. For all other institutions, the minimum leverage capital ratio is not less than 4%. Tier 1 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 Federal Deposit Insurance Corporation 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 1 capital. Total capital consists of Tier 1

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capital plus Tier 2 or supplementary capital, which includes 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 1 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 Federal Deposit Insurance Corporation, 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.

In July 2013, the Federal Deposit Insurance Corporation and the other federal bank regulatory agencies issued a final rule that will 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 final rule applies to all depository institutions, top-tier bank holding companies with total consolidated assets of \$500 million or more and all top-tier savings and loan holding companies. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-in or opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for WaterStone Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

#### Safety and Soundness Standards

Each federal banking agency, including the Federal Deposit Insurance Corporation, 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 1 risk-based capital ratio of 6.0% or more, has a Tier 1 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 1 risk-based capital ratio of 4.0% or more and a Tier 1 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 1 risk-based capital ratio that is less than 4.0% or a Tier 1 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% and a Tier 1 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 institution classified as less than well capitalized 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 that have insufficient capital to take corrective actions. For example, a savings bank that is categorized as “undercapitalized” may be subject to growth limitations and may be required to submit a capital restoration plan, and a holding company that controls such a savings bank may be required to guarantee that the savings bank complies with the restoration plan. A “significantly undercapitalized” savings bank may 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 adopted final rule that will increase regulatory capital requirements will adjust the prompt corrective action categories accordingly.

At June 30, 2013, WaterStone Bank was considered well-capitalized with a Tier 1 leverage ratio of 12.17%, a Tier 1 risk-based ratio of 17.61% and a total risk based capital ratio of 18.87%.

#### Regulatory Developments

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-Federal agreed to the issuance of an Order to Cease and Desist by the Office of Thrift Supervision, Waterstone-Federal’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 prohibited the payment of cash dividends to Waterstone-Federal without prior regulatory consent, and 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 Office of Thrift Supervision required, among other things, that Waterstone-Federal 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 also prohibited the payment of cash dividends or repurchases of common stock, and restricted the ability of Waterstone-Federal 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 required, among other things, maintenance of a minimum Tier 1 capital ratio of 8.0% and a minimum total risk based capital ratio of

12.0%, and also prohibited dividend payments without prior regulatory non-objection. The memorandum of understanding also required 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. Effective November 4, 2013, the WDFI and the Federal Deposit Insurance Corporation terminated the memorandum of understanding.

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Effective July 9, 2013, the Federal Reserve Board terminated the Order issued to Waterstone-Federal and requested that the board of directors adopt resolutions related to the operations of Waterstone-Federal. The board resolutions adopted by Waterstone-Federal require written approval from the Federal Reserve Board prior to the declaration or payment of dividends, any increase in debt or the redemption of holding company stock.

Failure to comply with the board resolutions could result in additional enforcement actions by the Federal Reserve Board. We have incurred significant expense in complying with the Orders, and continued compliance with the board resolutions may restrict our operations or result in continued expense, either of which could have adverse effects on our operations and financial condition.

#### Dividends

Under Wisconsin law and applicable regulations, a Wisconsin savings bank that meets its regulatory capital requirements 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 net profits for any calendar year may be declared and before a stock 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.

#### 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 savings bank’s average daily balance of net withdrawable accounts plus short-term borrowings (the “Required Liquidity Ratio”). At June 30, 2013, 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 a Wisconsin savings bank must consist of “primary liquid assets,” which are defined to include securities issued by the United States Government and United States Government agencies. At June 30, 2013, 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 June 30, 2013, WaterStone Bank met its Regulation D reserve requirements.

#### Transactions with Affiliates and Insiders

**Wisconsin Law and Regulation.** Under Wisconsin law, a savings 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 Federal Deposit Insurance Corporation. In addition, unless the prior approval of the WDFI is obtained, a savings 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 New Waterstone. 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 savings bank is any company or entity that controls, is controlled by or is under common control with the savings bank. A subsidiary of a savings bank that is not also a depository institution or a “financial subsidiary” under federal law is not treated as an affiliate of the savings bank for the purposes of Sections 23A and 23B; however, the Federal Deposit Insurance Corporation has the discretion to treat subsidiaries of a savings bank as affiliates on a case-by-case basis. Sections 23A and 23B limit the extent to which a savings bank or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such savings 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 savings bank to any of its affiliates must be secured by collateral in amounts ranging from 100% to 130% of the loan amounts, depending on the type of collateral. In addition, any covered transaction by a savings bank with an affiliate and any purchase of assets or services by a savings bank from an affiliate must be on terms that are substantially the same, or at least as favorable, to the savings 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 Federal Reserve Board’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 its insiders and insiders’ related interests in the aggregate may not exceed the savings 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 savings bank that is widely available to employees of the savings bank and that does not

give any preference to insiders of the savings bank over other employees of the savings bank. Consistent with these requirements, WaterStone Bank previously 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 WaterStone Bank's cost of funds on December 31 of the immediately preceding year and is adjusted annually. At June 30, 2013, the rate of interest on an employee rate mortgage loan was 1.68%, compared to the weighted average rate of 4.95% on all of WaterStone Bank's single-family mortgage loans. Employee rate mortgage loans totaled \$3.3 million, or 0.3% of our residential mortgage loan portfolio, on June 30, 2013.

#### 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 Federal Deposit Insurance Corporation. 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. Federal law also requires WaterStone Bank 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, 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 Community Reinvestment Act 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 Community Reinvestment Act. The Community Reinvestment Act requires the Federal Deposit Insurance Corporation, in connection with its examination of WaterStone Bank, to assess WaterStone Bank's record of meeting the credit needs of its community and to take that record into account in the Federal Deposit Insurance Corporation's evaluation of certain applications by WaterStone Bank. For example, the regulations specify that a bank's Community Reinvestment Act 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 Community Reinvestment Act compliance.

Federal Home Loan Bank System

The Federal Home Loan Bank System, consisting of 12 Federal Home Loan Banks, is under the jurisdiction of the Federal Housing Finance Board. The designated duties of the Federal Housing Finance Board are to supervise the Federal Home Loan Banks; ensure that the Federal Home Loan Banks carry out their housing

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finance mission; ensure that the Federal Home Loan Banks remain adequately capitalized and able to raise funds in the capital markets; and ensure that the Federal Home Loan Banks operate in a safe and sound manner.

WaterStone Bank, as a member of the Federal Home Loan Bank of Chicago, is required to acquire and hold shares of capital stock in the Federal Home Loan Bank of Chicago in specified amounts. WaterStone Bank is in compliance with this requirement with an investment in Federal Home Loan Bank of Chicago stock of \$20.2 million at June 30, 2013.

Among other benefits, the Federal Home Loan Banks provide a central credit facility primarily for member institutions. It is funded primarily from proceeds derived from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes advances to members in accordance with policies and procedures established by the Federal Housing Finance Board and the board of directors of the Federal Home Loan Bank of Chicago. At June 30, 2013, WaterStone Bank had \$350.0 million in advances from the Federal Home Loan Bank of Chicago.

#### USA PATRIOT Act

The USA PATRIOT Act gives the federal government 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") has resulted in significant changes to the regulation of insured depository institutions. 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, MHC and Waterstone-Federal, 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 primary bank 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 cannot yet be fully assessed. However, it is likely that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden, compliance costs and interest expense for WaterStone Bank and New Waterstone.



## Regulation of Waterstone Mortgage Corporation

Waterstone Mortgage Corporation is subject to numerous federal, state and local laws and regulations and may be subject to various judicial and administrative decisions imposing various requirements and restrictions on its business. These laws, regulations and judicial and administrative decisions to which Waterstone Mortgage Corporation is subject include those pertaining to: real estate settlement procedures; fair lending; fair credit reporting; truth in lending; compliance with net worth and financial statement delivery requirements; compliance with federal and state disclosure and licensing requirements; the establishment of maximum interest rates, finance charges and other charges; secured transactions; collection, foreclosure, repossession and claims-handling procedures; other trade practices and privacy regulations providing for the use and safeguarding of non-public personal financial information of borrowers; and guidance on non-traditional mortgage loans issued by the federal financial regulatory agencies. Waterstone Mortgage Corporation may also be required to comply with any additional requirements that its customers may be subject to by their regulatory authorities.

As a wholly-owned subsidiary of WaterStone Bank, Waterstone Mortgage Corporation is also subject to supervision and regulation by the WDFI and the Federal Deposit Insurance Corporation as part of their supervision and regulation of WaterStone Bank.

## Holding Company Regulation

New Waterstone will be a unitary savings and loan holding company subject to regulation and supervision by the Federal Reserve Board. The Federal Reserve Board will have enforcement authority over New Waterstone and its non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a risk to WaterStone Bank. In addition, 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. New Waterstone will be subject to regulation as a savings bank holding company under Wisconsin law. However, the WDFI has not issued specific regulations governing savings bank holding companies.

As a savings and loan holding company, New Waterstone's activities will be limited to those activities permissible by law for financial holding companies (if New Waterstone makes an election to be treated as a financial holding company and meets the other requirements to be a financial holding company) or multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, incidental to financial activities or complementary to a financial activity. Such activities include lending and other activities permitted for bank holding companies, insurance and underwriting equity securities. Multiple savings and loan holding companies are authorized to engage in activities specified by federal regulation.

Federal law prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring more than 5% of another savings institution or savings and loan holding company without prior written approval of the Federal Reserve Board, and from acquiring or retaining control of any depository institution not insured by the Federal Deposit Insurance Corporation. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider such things as the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on and the risk to the federal deposit insurance fund, the convenience and needs of the community and competitive factors. A savings and loan holding company may not acquire a savings institution in another state and hold the target institution as a separate subsidiary unless it is a supervisory acquisition under Section 13(k) of the Federal Deposit Insurance Act or the law of the state in which the target is located authorizes such acquisitions by out-of-state companies.

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 establish minimum consolidated capital requirements for all depository institution holding companies that are as stringent as those required for the insured depository subsidiaries. The components of Tier 1 capital are restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions, which excludes 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. The final capital rule discussed above implements the consolidated capital requirements for savings and loan holding companies effective January 1, 2015.

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. These regulatory policies may affect the ability of New Waterstone to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

#### Federal Securities Laws

New Waterstone common stock will be registered with the Securities and Exchange Commission after the conversion and stock offering. New Waterstone will be subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

The registration under the Securities Act of 1933 of shares of common stock issued in New Waterstone’s public offering does not cover the resale of those shares. Shares of common stock purchased by persons who are not affiliates of New Waterstone may be resold without registration. Shares purchased by an affiliate of New Waterstone will be subject to the resale restrictions of Rule 144 under the Securities Act of 1933. If New Waterstone meets the current public information requirements of Rule 144 under the Securities Act of 1933, each affiliate of New Waterstone that complies with the other conditions of Rule 144, including those that require the affiliate’s sale to be aggregated with those of other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three-month period, the greater of 1% of the outstanding shares of New Waterstone, or the average weekly volume of trading in the shares during the preceding four calendar weeks. In the future, New Waterstone may permit affiliates to have their shares registered for sale under the Securities Act of 1933.

#### Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 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. We have policies, procedures and systems

designed to comply with these regulations, and we review and document such policies, procedures and systems to ensure continued compliance with these regulations.

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## Change in Control Regulations

Under the Change in Bank Control Act, no person may acquire control of a savings and loan holding company such as New Waterstone unless the Federal Reserve Board has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the institution's directors, or a determination by the regulator that the acquiror has the power, directly or indirectly, to exercise a controlling influence over the management or policies of the institution. Acquisition of more than 10% of any class of a savings and loan holding company's voting stock constitutes a rebuttable determination of control under the regulations under certain circumstances including where, as will be the case with New Waterstone, the issuer has registered securities under Section 12 of the Securities Exchange Act of 1934.

In addition, federal regulations provide that no company may acquire control of a savings and loan holding company without the prior approval of the Federal Reserve Board. Any company that acquires such control becomes a "savings and loan holding company" subject to registration, examination and regulation by the Federal Reserve Board.

## TAXATION

### Federal Taxation

**General.** Lamplighter Financial, MHC, Waterstone-Federal and WaterStone Bank are, and New Waterstone will be, subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Waterstone-Federal, New Waterstone or WaterStone Bank.

All tax years prior to 2010 are closed to federal tax examination. During the quarter ended June 30, 2012, following receipt of notice from the Internal Revenue Service, we made a protective payment of \$982,000 to cover all tax adjustments and estimated interest and penalties resulting from an audit of our federal tax returns for calendar years 2005 through 2009.

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

**Bad Debt Reserves.** Prior to 1996, 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 tax law changes in 1996, 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 June 30, 2013, WaterStone Bank had no reserves subject to recapture in excess of its base year reserves.

Waterstone-Federal is required to use the specific charge-off method to account for tax bad debt deductions.

Taxable Distributions and Recapture. Prior to 1996, bad debt reserves created prior to 1988 were subject to recapture into taxable income if WaterStone Bank failed to meet certain thrift asset and definitional tests or made certain distributions. Tax law changes in 1996 eliminated thrift-related recapture rules. However, under current law, pre-1988 tax bad debt reserves remain subject to recapture if WaterStone Bank makes certain non-dividend distributions, repurchases any of its common stock, pays dividends in excess of earnings and profits, or fails to

qualify as a “bank” for tax purposes. At June 30, 2013, our total federal pre-base year bad debt reserve was approximately \$16.7 million.

**Alternative Minimum Tax.** The Internal Revenue Code imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, less any available exemption. The alternative minimum tax is imposed to the extent it exceeds the regular income tax. Net operating losses can offset no more than 90% of alternative taxable income. Certain payments of alternative minimum tax 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-Federal became subject to alternative minimum tax for 2006 and 2007. At June 30, 2013, Waterstone-Federal had no such amounts available as credits for carryover.

**Net Operating Loss Carryovers.** A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. 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. Waterstone-Federal had a federal net operating loss carryforward of \$3.0 million at December 31, 2011, which was fully utilized during the year ended December 31, 2012.

**Corporate Dividends-Received Deduction.** Waterstone-Federal may exclude from its federal taxable income 100% of dividends received from WaterStone Bank as a wholly-owned subsidiary by filing consolidated tax returns. The corporate dividends-received deduction is 80% when the corporation receiving the dividend owns at least 20% of the stock of the distributing corporation. The dividends-received deduction is 70% when the corporation receiving the dividend owns less than 20% of the distributing corporation.

#### State Taxation

Lamplighter Financial, MHC and Waterstone-Federal 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 our investment subsidiary, Wauwatosa Investments, Inc., 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%.

Our state tax returns have not been audited for the last five years.

As a Maryland business corporation, New Waterstone is required to file an annual report with and pay franchise taxes to the state of Maryland.

## MANAGEMENT

## Shared Management Structure

Each executive officer of New Waterstone is also an executive officer of WaterStone Bank. We expect that New Waterstone and WaterStone Bank will continue to have common executive officers until there is a business reason to establish separate management structures.

## Executive Officers

The following table sets forth information regarding our executive officers. Age information is as of December 31, 2012. The executive officers of New Waterstone and WaterStone Bank are elected annually. Except as noted below, each of our executive officers has held their positions listed below for at least the past five years.

Name	Age	Position
Douglas S. Gordon	55	President and Chief Executive Officer, New Waterstone and WaterStone Bank
Richard C. Larson	55	Chief Financial Officer and Senior Vice President, New Waterstone and WaterStone Bank
William F. Bruss	43	Chief Operating Officer (appointed June 2013), General Counsel and Secretary, New Waterstone and WaterStone Bank
Rebecca M. Arndt	45	Vice President, Retail Banking, WaterStone Bank
Eric J. Egenhoefer	37	President, Waterstone Mortgage Corporation

## Directors

Directors serve three-year staggered terms so that approximately one-third of the directors are elected at each annual meeting. Directors of WaterStone Bank will be elected by New Waterstone as its sole stockholder.

The following details include for each of our directors: their age as of December 31, 2012; the year in which they first became a director of WaterStone Bank; the year that their term expires; and their business experience for at least the past five years. Ms. Bartel and Ms. Rappé are directors of WaterStone Bank; each of our other directors is a director of New Waterstone, Lamplighter Financial, MHC, Waterstone-Federal and WaterStone Bank. None of the directors listed below currently serves as a director, or served as a director during the past five years, of a publicly-held entity (other than Waterstone-Federal). The following also includes the particular experience, qualifications, attributes, or skills considered by the Nominating and Corporate Governance Committee that led the board of directors to conclude that such person should serve as a director of Waterstone-Federal. The mailing address for each person listed is 11200 West Plank Court, Wauwatosa, Wisconsin 53226.



Name, Age, Director Since, Term Expiration	Experience, Qualifications, Attributes, Skills
Douglas S. Gordon, 55, director since 2005, term expires 2015	Chief Executive Officer and President of Waterstone-Federal and WaterStone Bank since January 2007; President and Chief Operating Officer of WaterStone Bank from 2005 to 2007; real estate investor. Mr. Gordon brings extensive prior banking experience as an executive officer of M&I Bank and Security Savings Bank. He has extensive firsthand knowledge and experience with our lending markets and our customers. Mr. Gordon has a B.A. from the University of Wisconsin – Parkside and an M.B.A. from Marquette University.
Ellen S. Bartel, 58, director since 2013, term expires 2016	President of Divine Savior Holy Angels (DSHA) High School (Milwaukee, Wisconsin) since 1998 where she has achieved significant improvements in DSHA’s curriculum, facilities, financial infrastructure, image, and reputation. Ms. Bartel has balanced DSHA’s budget for 15 consecutive years, oversaw endowment growth from under \$1 million to nearly \$10 million, and has developed recruitment strategies resulting in an incoming class wait list for 14 consecutive years. Prior to her employment at DSHA, Ms. Bartel held several positions at Alverno College (Milwaukee, Wisconsin) (1986 to 1997) with the most recent being Vice President of Institutional Advancement from 1994 to 1997. Ms. Bartel’s experience overseeing a large educational institution provides the board of directors with significant perspective on financial management and human resources matters. Ms. Bartel has a B.A. and an M.S.A. from the University of Notre Dame.
Thomas E. Dalum, 72, director since 1979, term expires 2016	Former chairman and CEO of UELC, an equipment leasing company and of DUECO, an equipment manufacturer and distributor. Mr. Dalum brings an entrepreneurial background, a long-standing record of community involvement and public service plus more than 30 years of experience as a member of the WaterStone Bank board of directors. Mr. Dalum has a B.A. from the University of Notre Dame and an M.B.A. from Northwestern University.
Michael L. Hansen, 61, director since 2003, term expires 2014	Business investor; current significant ownership interest in Jacsten Holdings LLC, Eagle Metal Finishing 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.

Patrick S. Lawton, 56, director  
since 2000, term expires 2015

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.

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Kristine A. Rappé, 56, director since 2013, term expires 2016	Special advisor to the Wisconsin Energy Foundation (Milwaukee, Wisconsin) following a 30-year career with Wisconsin Energy Corporation. In her roles at Wisconsin Energy Corporation as Vice President of Customer Services (1994 to 2001), Vice President and Corporate Secretary (2001 to 2004) and Senior Vice President and Chief Administrative Officer (2004 to 2012), Ms. Rappé had responsibility for shared services including information technology, human resources, supply chain management, business continuity/corporate security, and the WEC Foundation. Ms. Rappé's experience overseeing a large corporate entity provides the board of directors with significant perspective on financial management and human resources matters, and she has a long-standing history of community involvement and public service. Ms. Rappé has a B.A. from the University of Wisconsin – Oshkosh.
Stephen J. Schmidt, 51, director since 2002, term expires 2014	President of Schmidt and Bartelt Funeral and Cremation Services. Mr. Schmidt has entrepreneurial experience and extensive community contact throughout the communities served by WaterStone Bank. Mr. Schmidt has an Associate's Degree from the New England Institute and a B.A. from the University of Wisconsin – Stevens Point.

#### Board Independence

The board of directors determines the independence of each director in accordance with Nasdaq Stock Market rules, which include all elements of independence as set forth in the listing requirements for Nasdaq securities. 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 not required to be reported in this proxy statement/prospectus and that had an impact on our determination as to the independence of our directors.

#### Codes of Business Conduct and Ethics

Waterstone-Federal has adopted a code of business conduct and ethics that reflects current circumstances and Securities and Exchange Commission and Nasdaq definitions for such codes. The code of business conduct and ethics covers Waterstone-Federal, 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-Federal and subsidiaries. We have posted a copy of the code of business conduct and ethics on our corporate website, at [www.wsbonline.com](http://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.

#### Transactions With Certain Related Persons

WaterStone Bank offers the same loan and deposit products and services to its officers and directors, as well as their associates, as those offered to our customers generally. Our policy has been that transactions with its 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 previously entitled to receive a mortgage loan at a reduced interest rate, consistent with applicable laws and regulations. In December 2005, the board of directors discontinued the employee loan program for employee loans originated after

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March 31, 2006. Employee loans at reduced interest rates originated on or before March 31, 2006 continue on their same terms. Employees are subject to income tax on the difference between interest paid pursuant to their employee rate and interest that would have been paid pursuant to the non-employee rate.

The chart below lists the named executive officers who participated in the employee mortgage loan program during the years ended December 31, 2012, 2011 or 2010, and certain information with respect to their loans. No other directors or executive officers of Waterstone-Federal participated in the employee mortgage loan program during the years ended December 31, 2012, 2011 or 2010.

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

Name	Largest Aggregate Balance 01/01/11 to 12/31/11	Interest Rate	Non-employee Interest Rate	Principal Balance 12/31/11	Principal Paid 01/01/11 to 12/31/11	Interest Paid 01/01/11 to 12/31/11
Richard C. Larson	\$ 293,458	2.16 %	5.75 %	\$ 283,171	\$ 10,287	\$ 6,498
William F. Bruss	\$ 290,768	2.16 %	5.50 %	\$ 281,517	\$ 9,251	\$ 6,448

Name	Largest Aggregate Balance 01/01/10 to 12/31/10	Interest Rate	Non-employee Interest Rate	Principal Balance 12/31/10	Principal Paid 01/01/10 to 12/31/10	Interest Paid 01/01/10 to 12/31/10
Richard C. Larson	\$ 302,785	2.71 %	5.75 %	\$ 293,458	\$ 9,327	\$ 8,521
William F. Bruss	\$ 299,104	2.71 %	5.50 %	\$ 290,768	\$ 8,336	\$ 8,428

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.

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.

Since January 1, 2010, other than described above, and except for loans to directors made in the ordinary course of business that were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to WaterStone Bank and for which management believes neither involve more than the normal risk of collection nor present other unfavorable features, 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.

## 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)(2)	Total (\$)
Patrick S. Lawton Chairman of the Board	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

(1) Includes annual retainer, committee and chairman 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-officer director an annual retainer of \$36,000. In addition, annual fees paid to the Chairman of the Board totaled \$20,000, and annual fees paid to the Chairman of the Audit Committee and the Chairman of the Compensation Committee totaled \$10,000 and \$5,000, respectively. Each non-chair member of these two committees also received an annual fee of \$5,000. In 2012, total non-officer director cash compensation increased by \$229,000, or 179%, compared to 2011. Total non-officer director compensation expense as reported in the audited financial statements declined by \$254,000, or 42% due to the final vesting in January 2012 of all remaining equity incentives originally granted in 2007. 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-Federal's executive and director compensation for calendar 2012.

## Executive Compensation

### Compensation Discussion and Analysis

**Compensation Philosophy.** The primary objectives of our executive compensation programs are to attract and retain highly-qualified executives and to encourage extraordinary management efforts through well-designed incentive opportunities, with the goal of improving the performance of Waterstone-Federal and its subsidiaries consistent with the interests of our stockholders. 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 stockholder value as measured by the trading price of our common stock.

**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-Federal and its subsidiaries. The compensation committee's executive base salary review and analyses for calendar year 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-Federal 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 for determining WaterStone Bank's 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 executives in question. As a result of the net income generated in 2012, the compensation committee awarded discretionary 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 WaterStone Bank executives in 2012 in recognition of the significant operating performance achieved by the company. No bonuses were awarded to named WaterStone 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 book income generated by the subsidiary as adjusted for net interest income earned on intercompany advances from WaterStone Bank. The bonus pool established by the formula totaled \$200,000, 100% of which would be earned in the event that subsidiary pre-tax income exceeded \$10 million. No bonus would be earned for adjusted pre-tax income of less than \$1 million, with four income tiers between \$1 million and \$10 million which earned between 25% and 75% of the bonus pool. Adjusted pre-tax income for the year immediately preceding the establishment of this bonus formula totaled \$1.6 million. The formula was revised for 2012 to provide for a bonus of 5% of subsidiary pre-tax book income in excess of \$2 million, before bonus expense, as adjusted for (i) the difference between the cost of the intracompany line of credit provided by WaterStone Bank and third-party pricing, and (ii) \$100,000 as the estimated value of support services provided by WaterStone Bank. No bonus is payable if Waterstone Mortgage Corporation or WaterStone Bank becomes subject to a regulatory order caused or contributed to by the operations of Waterstone Mortgage Corporation.

**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 stockholders, 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 stockholders in May 2006, provide certain equity-based incentive compensation. Both restricted stock awards and option awards were granted to directors and WaterStone 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 was 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 Officer and the non-officer directors were not eligible for awards under the second grant due to regulatory limitations. Total 2011 compensation expense reported in the audited Waterstone-Federal consolidated financial statements included equity compensation expense of \$1,087,380 for the Chief Executive Officer and all non-officer directors. There is no comparable expense reported in 2012. Both 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 are intended to further the compensation committee's objectives of executive retention through longer vesting schedules and enhanced stockholder value due to the value of grants being tied to the trading price of our common stock. 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.

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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 WaterStone 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 WaterStone 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% from the year ended December 31, 2011, as a result of the significant improvement in Waterstone Federal's operating performance combined with the lack of available stock incentive compensation. That increase is exclusive of equity incentive compensation. Total 2011 compensation expense reported in the Waterstone-Federal 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 granted 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.

#### Compensation Committee Report

The compensation committee has reviewed and discussed the section of this proxy statement/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 proxy statement/prospectus.

This report has been provided by the compensation committee:

Thomas E. Dalum, Chairman

Michael L. Hansen

Stephen J. Schmidt

## Compensation Tables

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.

## SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary (\$)(1)	Bonus (\$)	Stock Awards (\$)(2)	Option Awards (\$)(2)	Non-Equity Incentive		Total (\$)
						Plan Compensation (\$)	All Other Compensation (\$)(3)	
Douglas S. Gordon Chief Executive Officer of Waterstone-Federal and WaterStone Bank	2012	780,000	350,000	—	—	—	16,552	1,146,552
	2011	420,000	—	—	—	—	16,263	436,263
	2010	420,000	—	—	—	—	7,320	427,320
Richard C. Larson Chief Financial Officer of Waterstone-Federal and WaterStone Bank	2012	240,000	30,000	47,250	37,500	—	23,857	378,607
	2011	236,000	—	—	—	—	21,458	257,458
	2010	233,400	—	—	—	—	19,762	253,162
William F. Bruss Chief Operating Officer and General Counsel of Waterstone-Federal and WaterStone Bank	2012	207,200	30,000	47,250	43,750	—	26,314	354,544
	2011	204,200	—	—	—	—	21,448	225,648
	2010	196,700	—	—	—	—	18,363	215,063
Eric J. Egenhoefer President of Waterstone Mortgage Corporation	2012	247,115	—	—	—	879,371	6,600	1,133,086
	2011	200,000	—	—	—	80,000	5,600	285,600
	2010	173,462	—	—	109,000	120,000	—	402,462
Rebecca M. Arndt Vice President, Retail Operations of WaterStone Bank	2012	152,000	20,000	28,350	25,000	—	16,938	242,288
	2011	148,000	—	—	—	—	12,064	160,064
	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 \$9,873 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 Corporation 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 fair value of stock awards is equal to the quoted market closing price of our common stock on the date of grant. The assumptions used in the valuation of stock options, as well as additional information related to these awards, are included in Note 10 to Waterstone-Federal's audited financial statements for the year ended December 31, 2012 included in Waterstone-Federal's Annual Report on Form 10-K for the year then ended, 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 \$10,323 for Messrs. Gordon and Mr. Larson, \$9,998 for Mr. Bruss and \$7,248 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 awards. The equity 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 following grant. The non-equity award granted to Mr. Egenhoefer is described above in “—Compensation Discussion and Analysis—Bonus.”

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

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			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 (\$)
		Threshold (\$)	Target (\$)	Maximum (\$)				
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
Eric J. Egenhoefer	(1)	(1 )	63,000 (1)	(1 )	—	—	—	—
Rebecca M. Arndt	1/4/12	—	—	—	15,000	—	—	28,350
	1/4/12	—	—	—	—	20,000	1.89	25,000

(1) On an annual basis, Mr. Egenhoefer is entitled to earn a bonus under the criteria described under “—Compensation Discussion and Analysis—Bonus.” There is no minimum, target or maximum amount. Therefore, pursuant to Securities and Exchange Commission regulations, the target amount listed is based upon operating results for the year ended December 31, 2011.

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

Name	Option Awards				Stock Awards	
	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)

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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

Name	Option Awards		Stock Awards	
	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.

#### Employment Agreement

Waterstone Mortgage Corporation is a party to an employment agreement with its President, Eric J. Egenhoefer. The employment agreement, which was entered into when WaterStone Bank acquired Waterstone Mortgage Corporation in 2006, has an initial term of three years and extends for one additional year at the end of each year during the term, commencing at the end of the initial term. Under the employment agreement, Mr. Egenhoefer is entitled to a base salary, which is currently \$250,000, and is also entitled to three weeks vacation, health, hospitalization, disability, dental, life and other insurance plan coverage paid by Waterstone Mortgage Corporation, reimbursement for all necessary business travel and out-of-pocket expenses incurred in the performance of his services, participation in company-wide employee benefits, including Waterstone Mortgage Corporation's 401(k) Plan and other qualified and non-qualified plans that may be maintained by the company. Mr. Egenhoefer is also entitled to participate in a Bonus Compensation Plan sponsored by Waterstone Mortgage Corporation.

Under the employment agreement, Mr. Egenhoefer may terminate his employment for "good reason," which is defined to include any material breach of the employment agreement by Waterstone Mortgage Corporation, including the failure, without "good cause" (as defined in the employment agreement), to pay the amounts due under the agreement on a timely basis. In the event the employment agreement is terminated for good reason, he is entitled to receive all compensation, benefits and reimbursements through the date of termination, as well as an additional 25% of his base salary at the rate then in effect. In the event of his termination due to disability, Mr. Egenhoefer will be entitled to receive the lesser of (i) 33% of his base salary at the rate then in effect or (ii) his base salary for the remaining term of the employment agreement. In the event of his death during the term of the employment agreement, the agreement will terminate with no severance compensation to his estate. Similarly, in the event of his termination for good cause, Mr. Egenhoefer will not be entitled to any severance compensation.

In the event of his termination of employment, the employment agreement contains provisions which prevent Mr. Egenhoefer from soliciting business from customers of Waterstone Mortgage Corporation or the withdrawal of any customers business, or the hiring of any employees, consultants or personnel of Waterstone Mortgage Corporation. In



addition, he must not disclose confidential information or compete with Waterstone Mortgage Corporation for one year following termination of employment. In consideration of these restrictive provisions, Mr. Egenhoefer was paid an additional \$50,000 upon his entering into the agreement.

#### 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-Federal for the purchase of 761,515 shares, which represented 7.5% of the total Waterstone-Federal 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 by purchasing outstanding shares in the market or from individual stockholders or from authorized but unissued shares or shares held in treasury by Waterstone-Federal. 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.

The Employee Stock Ownership Plan intends to purchase 8% of the shares of common stock sold in the offering.

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. WaterStone Bank employees over the age of 18 and Waterstone Mortgage Corporation 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 Corporation 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

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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. The WaterStone Bank 401(k) Plan has been amended to give participants in the plan the opportunity to buy shares of New Waterstone with their 401(k) Plan account balances, both in the offering and after the offering in the open market.

#### Say-on-Pay

At the 2011 Annual Meeting, stockholders voted, on an advisory basis, whether to approve the compensation paid to the Named Executive Officers. A majority of the votes were cast in favor of the resolution to approve the executive compensation described in the Proxy Statement. Stockholders also voted on a non-binding proposal to establish whether stockholders should vote on executive compensation every one, two or three years. A majority of the votes were cast in favor of holding the non-binding vote on executive compensation every year. The board of directors took this vote into account in passing a resolution in which it approved holding a non-binding stockholder vote on executive compensation every year.

#### Benefits to be Considered Following Completion of the Conversion

Following the stock offering, we intend to adopt one or more new stock-based benefit plans that will provide for grants of stock options and restricted common stock awards. If adopted within 12 months following the completion of the conversion, the aggregate number of shares reserved for the exercise of stock options or available for stock awards under the stock-based benefit plans would be limited to 10% and 4%, respectively, of the shares sold in the stock offering.

The stock-based benefit plans will not be established sooner than six months after the stock offering, and if adopted within one year after the stock offering, the plans must be approved by a majority of the votes eligible to be cast by our stockholders. If stock-based benefit plans are established more than one year after the stock offering, they must be approved by a majority of votes cast by our stockholders. The following additional restrictions would apply to our stock-based benefit plans only if such plans are adopted within one year after the stock offering:

non-employee directors in the aggregate may not receive more than 30% of the options and restricted stock awards authorized under the plans;

any one non-employee director may not receive more than 5% of the options and restricted stock awards authorized under the plans;

any officer or employee may not receive more than 25% of the options and restricted stock awards authorized under the plans;

any tax-qualified employee stock benefit plans and restricted stock plan, in the aggregate, may not acquire more than 10% of the shares sold in the offering, unless WaterStone Bank has tangible capital of 10% or more, in which case tax-qualified employee stock benefit plans and restricted stock plans may acquire up to 12% of the shares sold in the offering;

the options and restricted stock awards may not vest more rapidly than 20% per year, beginning on the first anniversary of stockholder approval of the plans;

accelerated vesting is not permitted except for death, disability or upon a change in control of WaterStone Bank or New Waterstone; and

- our executive officers or directors must exercise or forfeit their options in the event that WaterStone Bank becomes critically undercapitalized, is subject to enforcement action or receives a capital directive.

We have not determined whether we will present stock-based benefit plans for stockholder approval prior to or more than 12 months after the completion of the conversion. In the event either federal or state regulators change their regulations or policies regarding stock-based benefit plans, including any regulations or policies restricting the size of awards and vesting of benefits as described above, the restrictions described above may not be applicable.

We may obtain the shares needed for our stock-based benefit plans by issuing additional shares of common stock from authorized but unissued shares or through stock repurchases.

The actual value of the shares awarded under stock-based benefit plans would be based in part on the price of New Waterstone's common stock at the time the shares are awarded. The stock-based benefit plans are subject to stockholder approval, and cannot be implemented until at least six months after the offering. The following table presents the total value of all shares of restricted stock that would be available for issuance under the stock-based benefit plans, assuming the shares are awarded when the market price of our common stock ranges from \$8.00 per share to \$14.00 per share.

Share Price	748,000	880,000	1,012,000
	Shares	Shares	Shares
	Awarded at	Awarded at	Awarded at
	Minimum	Midpoint of	Maximum of
	of Offering	Offering	Offering
	Range	Range	Range
(In thousands, except share price information)			
\$8.00	\$ 5,984	\$ 7,040	\$ 8,096
10.00	7,480	8,800	10,120
12.00	8,976	10,560	12,144
14.00	10,472	12,320	14,168

The grant-date fair value of the options granted under the stock-based benefit plans will be based in part on the price of shares of common stock of New Waterstone at the time the options are granted. The value also will depend on the various assumptions utilized in the option pricing model ultimately adopted. The following table presents the total estimated value of the options to be available for grant under the stock-based benefit plans, assuming the market price and exercise price for the stock options are equal and the range of market prices for the shares is \$8.00 per share to \$14.00 per share. The Black-Scholes option pricing model provides an estimate only of the fair value of the options, and the actual value of the options may differ significantly from the value set forth in this table.

Exercise Price	Grant-Date Fair Value Per Option	1,870,000	2,200,000	2,530,000
		Options	Options	Options
		at	at	at
		Minimum	Midpoint	Maximum
		of	of	of
		Offering	Offering	Offering
		Range	Range	Range

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(In thousands, except exercise price and fair value information)

\$8.00	\$ 2.08	\$ 3,890	\$ 4,576	\$ 5,262
10.00	2.60	4,862	5,720	6,578
12.00	3.12	5,834	6,864	7,894
14.00	3.64	6,807	8,008	9,209

The tables presented above are provided for informational purposes only. There can be no assurance that our stock price will not trade below \$10.00 per share. Before you make an investment decision, we urge you to read this proxy statement/prospectus carefully, including, but not limited to, the section entitled "Risk Factors" beginning on page 21.

## BENEFICIAL OWNERSHIP OF COMMON STOCK

The following table provides the beneficial ownership of shares of common stock of Waterstone-Federal 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 October 31, 2013.

Name of Beneficial Owner	Total Shares Beneficially Owned (1)(2)		Percent of All Common Stock Outstanding	
Rebecca M. Arndt	61,828		*	
Ellen S. Bartel	—		—	
William F. Bruss	105,958	(3)	*	
Thomas E. Dalum	98,351		*	
Eric J. Egenhoefer	49,635		*	
Douglas S. Gordon	434,511		1.4	%
Michael L. Hansen	240,844		*	
Richard C. Larson	130,009		*	
Patrick S. Lawton	201,953		*	
Kristine A. Rappé	—		—	
Stephen J. Schmidt	76,500		*	
All directors and executive officers as a group (11 persons) (4)	1,551,892		4.9	%
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.
- (2) Includes the following shares underlying options which are exercisable within 60 days of October 31, 2013: Ms. Arndt – 25,000; Mr. Bruss – 57,000; Messrs. Dalum, Hansen, Lawton and Schmidt – 50,000 shares each; Mr. Egenhoefer – 20,000; Mr. Gordon – 250,000; Mr. Larson – 56,000; all directors and executive officers as a group – 612,000.
- (3) Includes 5,000 shares pledged as collateral for a loan.
- (4) 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. Employees 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.





## SUBSCRIPTIONS BY DIRECTORS AND EXECUTIVE OFFICERS

The table below sets forth, for each of New Waterstone's directors and executive officers, and for all of these individuals as a group, the following information:

- (i) the number of exchange shares to be held upon completion of the conversion, based upon their beneficial ownership of Waterstone-Federal common stock as of October 31, 2013;
- (ii) the proposed purchases of subscription shares, assuming sufficient shares of common stock are available to satisfy their subscriptions; and
- (iii) the total shares of common stock to be held upon completion of the conversion.

In each case, it is assumed that subscription shares are sold at the minimum of the offering range. See "Proposal 1 — Approval of the Plan of Conversion and Reorganization—Additional Limitations on Common Stock Purchases." Federal regulations prohibit our directors and officers from selling the shares they purchase in the offering for one year after the date of purchase. Subscriptions by management through our 401(k) plan are included in the proposed purchases set forth below and will be counted as part of the maximum number of shares such individuals may subscribe for in the stock offering and as part of the maximum number of shares directors and officers may purchase in the stock offering.

Name of Beneficial Owner	Number of Exchange Shares to Be Held (1)	Proposed Purchases of Stock in the Offering (2)		Total Common Stock to be Held at Minimum of Offering Range (3)	Percentage of Shares Outstanding
		Number of Shares	Amount	Number of Shares	
R e b e c c a M . Arndt	50,148	20,000	\$ 200,000	70,148	*
E l l e n S . B a r t e l Ellen S. Bartel	—	5,000	50,000	5,000	*
W i l l i a m F . Bruss	85,942	12,500	125,000	98,442	*
T h o m a s E . Dalum	79,772	25,000	250,000	104,772	*
E r i c J . Egenhoefer	40,258	10,000	100,000	50,258	*
D o u g l a s S . Gordon	352,431	50,000	500,000	402,431	1.6 %
M i c h a e l L . Hansen	195,348	25,000	250,000	220,348	*
R i c h a r d C . Larson	105,450	1,000	10,000	106,450	*

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P a t r i c k S . Lawton	163,804	30,000	300,000	193,804	*
K r i s t i n e A . Rappé	—	10,000	100,000	10,000	*
S t e p h e n J . Schmidt	62,049	10,000	100,000	72,049	*
Total for Directors and Executive Officers	1,135,202	198,500	\$ 1,985,000	1,333,702	5.1 %

\* Less than 1%.

(1) Based on information presented in “Beneficial Ownership of Common Stock,” and assuming an exchange ratio of 0.8111 at the minimum of the offering range.

(2) Includes proposed subscriptions, if any, by associates.

(3) At the maximum of the offering range, directors and executive officers would beneficially own 1,734,264 shares, or 4.9% of our outstanding shares of common stock when including stock options exercisable within 60 days of October 31, 2013.

COMPARISON OF STOCKHOLDERS’ RIGHTS FOR EXISTING  
STOCKHOLDERS OF WATERSTONE FINANCIAL, INC.

General. As a result of the conversion, existing stockholders of Waterstone-Federal will become stockholders of New Waterstone. There are differences in the rights of stockholders of Waterstone-Federal and

stockholders of New Waterstone caused by differences between federal and Maryland law and regulations and differences in Waterstone-Federal's federal stock charter and bylaws and New Waterstone's Maryland articles of incorporation and bylaws.

This discussion is not intended to be a complete statement of the differences affecting the rights of stockholders, but rather summarizes the material differences and similarities affecting the rights of stockholders. See "Where You Can Find Additional Information" for procedures for obtaining a copy of New Waterstone's articles of incorporation and bylaws.

**Authorized Capital Stock.** The authorized capital stock of Waterstone-Federal consists of 200,000,000 shares of common stock, \$0.01 par value per share, and 20,000,000 shares of preferred stock, \$0.01 par value per share.

The authorized capital stock of New Waterstone consists of 100,000,000 shares of common stock, \$0.01 par value per share, and 50,000,000 shares of preferred stock, par value \$0.01 per share.

Under Maryland General Corporation Law and New Waterstone's articles of incorporation, the board of directors may increase or decrease the number of authorized shares without stockholder approval. Stockholder approval is required to increase or decrease the number of authorized shares of Waterstone-Federal.

Waterstone-Federal's charter and New Waterstone's articles of incorporation both authorize the board of directors to establish one or more series of preferred stock and, for any series of preferred stock, to determine the terms and rights of the series, including voting rights, dividend rights, conversion and redemption rates and liquidation preferences. As a result of the ability to fix voting rights for a series of preferred stock, our board of directors has the power, to the extent consistent with its fiduciary duty, to issue a series of preferred stock to persons friendly to management in order to attempt to block a hostile tender offer, merger or other transaction by which a third party seeks control. We currently have no plans for the issuance of additional shares for such purposes.

**Issuance of Capital Stock.** Pursuant to applicable laws and regulations, Lamplighter Financial, MHC is required to own not less than a majority of the outstanding shares of Waterstone-Federal common stock. Lamplighter Financial, MHC will no longer exist following completion of the conversion.

New Waterstone's articles of incorporation do not contain restrictions on the issuance of shares of capital stock to directors, officers or controlling persons, whereas Waterstone-Federal's charter restricts such issuances to general public offerings, or to directors for qualifying shares, unless the share issuance or the plan under which they would generally be issued has been approved by stockholders. However, stock-based compensation plans, such as stock option plans and restricted stock plans, would have to be submitted for approval by New Waterstone stockholders due to requirements of the Nasdaq Stock Market and in order to qualify stock options for favorable federal income tax treatment.

**Voting Rights.** Neither Waterstone-Federal's charter or bylaws nor New Waterstone's articles of incorporation or bylaws provide for cumulative voting for the election of directors. For additional information regarding voting rights, see "—Limitations on Voting Rights of Greater-than-10% Stockholders" below.

**Payment of Dividends.** Waterstone-Federal's ability to pay dividends depends, to a large extent, upon WaterStone Bank's ability to pay dividends to Waterstone-Federal, which is restricted by Wisconsin statutes and by federal income tax considerations related to savings banks.

The same restrictions will apply to WaterStone Bank's payment of dividends to New Waterstone. In addition, Maryland law generally provides that New Waterstone is limited to paying dividends in an amount equal to its capital surplus over payments that would be owed upon dissolution to stockholders whose preferential rights upon dissolution are superior to those receiving the dividend, and to an amount that would not make it insolvent.

Board of Directors. Waterstone-Federal's bylaws and New Waterstone's articles of incorporation require the board of directors to be divided into three classes and that the members of each class shall be elected for a term of three years and until their successors are elected and qualified, with one class being elected annually.

Under Waterstone-Federal's bylaws, any vacancies on the board of directors may be filled by the affirmative vote of a majority of the remaining directors although less than a quorum of the board of directors. Persons elected by the board of directors of Waterstone-Federal to fill vacancies may only serve until the next election of directors by stockholders. Under New Waterstone's bylaws, any vacancy occurring on the board of directors, including any vacancy created by reason of an increase in the number of directors, may be filled only by the affirmative vote of two-thirds of the remaining directors, and any director so chosen shall hold office for the remainder of the term to which the director has been elected and until his or her successor is elected and qualified.

Limitations on Liability. The charter and bylaws of Waterstone-Federal do not limit the personal liability of directors or officers.

New Waterstone's articles of incorporation provide that directors and officers will not be personally liable for monetary damages to New Waterstone for certain actions as directors or officers, except for (i) receipt of an improper personal benefit, (ii) actions or omissions that are determined to have materially involved active and deliberate dishonesty, or (iii) to the extent otherwise provided by Maryland law. These provisions might, in certain instances, discourage or deter stockholders or management from bringing a lawsuit against directors or officers for a breach of their duties even though such an action, if successful, might benefit New Waterstone.

Indemnification of Directors, Officers, Employees and Agents. As generally allowed under current Federal Reserve Board regulations, Waterstone-Federal will indemnify its directors, officers and employees for any reasonable costs incurred in connection with any litigation involving such person's activities as a director, officer or employee if such person obtains a final judgment on the merits in his or her favor. In addition, indemnification is permitted in the case of a settlement, a final judgment against such person, or final judgment other than on the merits, if a majority of disinterested directors determines that such person was acting in good faith within the scope of his or her employment as he or she could reasonably have perceived it under the circumstances and for a purpose he or she could reasonably have believed under the circumstances was in the best interests of Waterstone-Federal or its stockholders. Waterstone-Federal also is permitted to pay ongoing expenses incurred by a director, officer or employee if a majority of disinterested directors concludes that such person may ultimately be entitled to indemnification. Before making any indemnification payment, Waterstone-Federal is required to notify the Federal Reserve Board of its intention, and such payment cannot be made if the Federal Reserve Board objects to such payment.

The articles of incorporation of New Waterstone provide that it shall indemnify (i) its current and former directors and officers to the fullest extent required or permitted by Maryland law, including the advancement of expenses, and (ii) other employees or agents to such extent as shall be authorized by the board of directors and Maryland law, all subject to any applicable federal law. Maryland law allows New Waterstone to indemnify any person for expenses, liabilities, settlements, judgments and fines in suits in which such person has been made a party by reason of the fact that he or she is or was a director, officer or employee of New Waterstone. No such indemnification may be given if the acts or omissions of the person are adjudged to be in bad faith and material to the matter giving rise to the proceeding, if such person is liable to the corporation for an unlawful distribution, or if such person personally received a benefit to which he or she was not entitled. The right to indemnification includes the right to be paid the expenses incurred in advance of final disposition of a proceeding.

Special Meetings of Stockholders. Waterstone-Federal's bylaws provide that special meetings of stockholders may be called by the chairman, the president, a majority of the members of the board of directors or the holders of not less than 10% of the outstanding capital stock entitled to vote at the meeting. New Waterstone's bylaws provide that special meetings of stockholders may be called by the chairman, the vice chairman, by a majority vote of the total authorized directors, or upon the written request of stockholders entitled to cast at least a majority of all votes entitled to vote at the meeting.

**Stockholder Nominations and Proposals.** Waterstone-Federal's bylaws provide that stockholders may submit nominations for election of directors at an annual meeting of stockholders and may propose any new business to be taken up at such a meeting by filing the proposal in writing with Waterstone-Federal at least five days before the date of any such meeting.

New Waterstone's bylaws provide that any stockholder desiring to make a nomination for the election of directors or a proposal for new business at a meeting of stockholders must submit written notice to New Waterstone at least 80 days prior and not earlier than 90 days prior to such meeting. However, if less than 90 days' notice or prior public disclosure of the date of the meeting is given to stockholders, such written notice must be submitted by a stockholder not later than the tenth day following the day on which notice of the meeting was mailed to stockholders or such public disclosure was made.

Management believes that it is in the best interest of New Waterstone and its stockholders to provide sufficient time to enable management to disclose to stockholders information about a dissident slate of nominations for directors. This advance notice requirement may also give management time to solicit its own proxies in an attempt to defeat any dissident slate of nominations, should management determine that doing so is in the best interests of stockholders generally. Similarly, adequate advance notice of stockholder proposals will give management time to study such proposals and to determine whether to recommend to the stockholders that such proposals be adopted. In certain instances, such provisions could make it more difficult to oppose management's nominees or proposals, even if stockholders believe such nominees or proposals are in their best interests.

**Stockholder Action Without a Meeting.** Neither the bylaws of Waterstone-Federal nor New Waterstone provide for action to be taken by stockholders without a meeting. However, under Maryland law, action may be taken by stockholders without a meeting if all stockholders entitled to vote on the action consent to taking such action without a meeting.

**Stockholder's Right to Examine Books and Records.** A federal regulation, which is applicable to Waterstone-Federal, provides that stockholders may inspect and copy specified books and records after proper written notice for a proper purpose. Maryland law provides that a stockholder may inspect a company's bylaws, stockholder minutes, annual statement of affairs and any voting trust agreements. However, only a stockholder or group of stockholders who together, for at least six months, hold at least 5% of the company's total shares, have the right to inspect a company's stock ledger, list of stockholders and books of accounts.

**Limitations on Voting Rights of Greater-than-10% Stockholders.** New Waterstone's articles of incorporation provide that no beneficial owner, directly or indirectly, of more than 10% of the outstanding shares of common stock will be permitted to vote any shares in excess of such 10% limit. Waterstone-Federal's charter does not contain voting limits based on stock ownership.

In addition, federal regulations provide that for a period of three years following the date of the completion of the offering, no person, acting singly or together with associates in a group of persons acting in concert, may directly or indirectly offer to acquire or acquire the beneficial ownership of more than 10% of a class of New Waterstone's equity securities without the prior written approval of the Federal Reserve Board. Where any person acquires beneficial ownership of more than 10% of a class of New Waterstone's equity securities without the prior written approval of the Federal Reserve Board, the securities beneficially owned by such person in excess of 10% may not be voted by any person or counted as voting shares in connection with any matter submitted to the stockholders for a vote, and will not be counted as outstanding for purposes of determining the affirmative vote necessary to approve any matter submitted to the stockholders for a vote.



Business Combinations with Interested Stockholders. Under Maryland law, “business combinations” between New Waterstone and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, statutory share exchange or, in circumstances specified in the statute, certain transfers of assets, certain stock issuances and transfers, liquidation plans and reclassifications involving interested stockholders and their affiliates or issuance or reclassification of equity securities. Maryland

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law defines an interested stockholder as: (i) any person who beneficially owns 10% or more of the voting power of New Waterstone's voting stock after the date on which New Waterstone had 100 or more beneficial owners of its stock; or (ii) an affiliate or associate of New Waterstone at any time after the date on which New Waterstone had 100 or more beneficial owners of its stock who, within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the then-outstanding voting stock of New Waterstone. A person is not an interested stockholder under the statute if the board of directors approved in advance the transaction by which the person otherwise would have become an interested stockholder. However, in approving a transaction, the board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the board.

After the five-year prohibition, any business combination between New Waterstone and an interested stockholder generally must be recommended by the board of directors of New Waterstone and approved by the affirmative vote of at least: (i) 80% of the votes entitled to be cast by holders of outstanding shares of voting stock of New Waterstone, and (ii) two-thirds of the votes entitled to be cast by holders of voting stock of New Waterstone other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder. These super-majority vote requirements do not apply if New Waterstone's common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares.

Current federal regulations do not provide a vote standard for business combinations involving federal mid-tier stock holding companies.

**Mergers, Consolidations and Sales of Assets.** Under New Waterstone's articles of incorporation, a merger or consolidation of New Waterstone requires approval of a majority of all votes entitled to be cast by stockholders. However, no approval by stockholders is required for a merger if:

- the plan of merger does not make an amendment to the articles of incorporation that would be required to be approved by the stockholders;
- each stockholder of the surviving corporation whose shares were outstanding immediately before the effective date of the merger will hold the same number of shares, with identical designations, preferences, limitations, and rights, immediately after; and
- the number of shares of any class or series of stock outstanding immediately after the effective time of the merger will not increase by more than 20% the total number of voting shares outstanding immediately before the merger.

In addition, under certain circumstances the approval of the stockholders shall not be required to authorize a merger with or into a 90% owned subsidiary of New Waterstone.

Under Maryland law, a sale of all or substantially all of New Waterstone's assets other than in the ordinary course of business, or a voluntary dissolution of New Waterstone, requires the approval of its board of directors and the affirmative vote of two-thirds of the votes of stockholders entitled to be cast on the matter.

Current federal regulations do not provide a vote standard for mergers, consolidations or sales of assets by federal mid-tier stock holding companies.

Evaluation of Offers. The articles of incorporation of New Waterstone provide that its board of directors, when evaluating a transaction that would or may involve a change in control of New Waterstone (whether by purchases of its securities, merger, consolidation, share exchange, dissolution, liquidation, sale of all or substantially all of its assets, proxy solicitation or otherwise), may, in connection with the exercise of its business judgment in determining what is in the best interests of New Waterstone and its stockholders and in making any recommendation to the stockholders, give due consideration to all relevant factors, including, but not limited to:

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- the economic effect, both immediate and long-term, upon New Waterstone's stockholders, including stockholders, if any, who do not participate in the transaction;
- the social and economic effect on the present and future employees, creditors and customers of, and others dealing with, New Waterstone and its subsidiaries and on the communities in which New Waterstone and its subsidiaries operate or are located;
- whether the proposal is acceptable based on the historical, current or projected future operating results or financial condition of New Waterstone;
- whether a more favorable price could be obtained for New Waterstone's stock or other securities in the future;
- the reputation and business practices of the other entity to be involved in the transaction and its management and affiliates as they would affect the employees of New Waterstone and its subsidiaries;
- the future value of the stock or any other securities of New Waterstone or the other entity to be involved in the proposed transaction;
  - any antitrust or other legal and regulatory issues that are raised by the proposal;
- the business and historical, current or expected future financial condition or operating results of the other entity to be involved in the transaction, including, but not limited to, debt service and other existing financial obligations, financial obligations to be incurred in connection with the proposed transaction, and other likely financial obligations of the other entity to be involved in the proposed transaction; and
- the ability of New Waterstone to fulfill its objectives as a financial institution holding company and on the ability of its subsidiary financial institution(s) to fulfill the objectives of a federally insured financial institution under applicable statutes and regulations.

If the board of directors determines that any proposed transaction should be rejected, it may take any lawful action to defeat such transaction.

Waterstone-Federal's charter and bylaws do not contain a similar provision.

**Dissenters' Rights of Appraisal.** Under Maryland law, stockholders of New Waterstone will not have dissenters' appraisal rights in connection with a plan of merger or consolidation to which New Waterstone is a party as long as the common stock of New Waterstone trades on a national securities exchange.

Current federal regulations do not provide for dissenters' appraisal rights for stockholders of federal mid-tier stock holding companies.

**Amendment of Governing Instruments.** No amendment of Waterstone-Federal's stock charter may be made unless it is first proposed by the board of directors then approved or preapproved by the Federal Reserve Board, and thereafter approved by the holders of a majority of the total votes eligible to be cast at a legal meeting. Amendments to Waterstone-Federal's bylaws require either preliminary approval by or post-adoption notice to the Federal Reserve Board as well as approval of the amendment by a majority vote of the authorized board of directors, or by a majority of the votes cast by the stockholders of Waterstone-Federal at any legal meeting.

New Waterstone's articles of incorporation may be amended, upon the submission of an amendment by the board of directors to a vote of the stockholders, by the affirmative vote of at least two-thirds of the outstanding

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shares of common stock, or by the affirmative vote of a majority of the outstanding shares of common stock if at least two-thirds of the members of the whole board of directors approves such amendment; provided, however, that approval by at least 80% of the outstanding voting stock is generally required to amend the following provisions:

- (i) The limitation on voting rights of persons who directly or indirectly beneficially own more than 10% of the outstanding shares of common stock;
- (ii) The division of the board of directors into three staggered classes;
- (iii) The ability of the board of directors to fill vacancies on the board;
- (iv) The requirement that directors may only be removed for cause and by the affirmative vote of at least a majority of the votes eligible to be cast by stockholders;
- (v) The ability of the board of directors to amend and repeal the bylaws;
- (vi) The ability of the board of directors to evaluate a variety of factors in evaluating offers to purchase or otherwise acquire New Waterstone;
- (vii) The authority of the board of directors to provide for the issuance of preferred stock;
- (viii) The validity and effectiveness of any action lawfully authorized by the affirmative vote of the holders of a majority of the total number of outstanding shares of common stock;
- (ix) The number of stockholders constituting a quorum or required for stockholder consent;
- (x) The indemnification of current and former directors and officers, as well as employees and other agents, by New Waterstone;
- (xi) The limitation of liability of officers and directors to New Waterstone for money damages;
- (xii) The inability of stockholders to cumulate their votes in the election of directors;
- (xiii) The advance notice requirements for stockholder proposals and nominations; and
- (xiv) The provision of the articles of incorporation requiring approval of at least 80% of the outstanding voting stock to amend the provisions of the articles of incorporation provided in (i) through (xiii) of this list.

The articles of incorporation also provide that the bylaws may be amended by the affirmative vote of a majority of our directors or by the stockholders by the affirmative vote of at least 80% of the total votes eligible to be voted at a duly constituted meeting of stockholders. Any amendment of this super-majority requirement for amendment of the bylaws would also require the approval of 80% of the outstanding voting stock.

#### RESTRICTIONS ON ACQUISITION OF NEW WATERSTONE

Although the board of directors of New Waterstone is not aware of any effort that might be made to obtain control of New Waterstone after the conversion, the board of directors believes that it is appropriate to include certain provisions

as part of New Waterstone's articles of incorporation to protect the interests of New Waterstone and its stockholders from takeovers which the board of directors might conclude are not in the best interests of WaterStone Bank, New Waterstone or New Waterstone's stockholders.

The following discussion is a general summary of the material provisions of Maryland law, New Waterstone's articles of incorporation and bylaws and certain other regulatory provisions that may be deemed to

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have an “anti-takeover” effect. The following description is necessarily general and is not intended to be a complete description of the document or regulatory provision in question. New Waterstone’s articles of incorporation and bylaws are included as part of Lamplighter Financial, MHC’s application for conversion filed with the Federal Reserve Board and New Waterstone’s registration statement filed with the Securities and Exchange Commission. See “Where You Can Find Additional Information.”

#### Maryland Law and Articles of Incorporation and Bylaws of New Waterstone

Maryland law, as well as New Waterstone’s articles of incorporation and bylaws, contain a number of provisions relating to corporate governance and rights of stockholders that may discourage future takeover attempts. As a result, stockholders who might desire to participate in such transactions may not have an opportunity to do so. In addition, these provisions will also render the removal of the board of directors or management of New Waterstone more difficult.

**Directors.** The board of directors will be divided into three classes. The members of each class will be elected for a term of three years and only one class of directors will be elected annually. Thus, it would take at least two annual elections to replace a majority of the board of directors. The bylaws establish qualifications for board members, including restrictions on affiliations with competitors of WaterStone Bank and restrictions based upon prior legal or regulatory violations. Further, the bylaws impose notice and information requirements in connection with the nomination by stockholders of candidates for election to the board of directors or the proposal by stockholders of business to be acted upon at an annual meeting of stockholders. Such notice and information requirements are applicable to all stockholder business proposals and nominations, and are in addition to any requirements under the federal securities laws.

**Restrictions on Call of Special Meetings.** The articles of incorporation and bylaws provide that special meetings of stockholders can be called by the president, by a majority of the whole board of directors or upon the written request of stockholders entitled to cast at least a majority of all votes entitled to vote at the meeting.

**Prohibition of Cumulative Voting.** The articles of incorporation prohibit cumulative voting for the election of directors.

**Limitation of Voting Rights.** The articles of incorporation provide that in no event will any person who beneficially owns more than 10% of the then-outstanding shares of common stock, be entitled or permitted to vote any of the shares of common stock held in excess of the 10% limit. This provision has been included in the articles of incorporation in reliance on Section 2-507(a) of the Maryland General Corporation Law, which entitles stockholders to one vote for each share of stock unless the articles of incorporation provide for a greater or lesser number of votes per share or limit or deny voting rights.

**Restrictions on Removing Directors from Office.** The articles of incorporation provide that directors may be removed only for cause, and only by the affirmative vote of the holders of at least a majority of the voting power of all of our then-outstanding common stock entitled to vote (after giving effect to the limitation on voting rights discussed above in “—Limitation of Voting Rights.”).

**Authorized but Unissued Shares.** After the conversion, New Waterstone will have authorized but unissued shares of common and preferred stock. See “Description of Capital Stock of New Waterstone Following the Conversion.” The articles of incorporation authorize 50,000,000 shares of serial preferred stock. New Waterstone is authorized to issue



preferred stock from time to time in one or more series subject to applicable provisions of law, and the board of directors is authorized to fix the designations, and relative preferences, limitations, voting rights, if any, including without limitation, offering rights of such shares (which could be multiple or as a separate class). In the event of a proposed merger, tender offer or other attempt to gain control of New Waterstone that the board of directors does not approve, it may be possible for the board of directors to authorize the issuance of a series of preferred stock with rights and preferences that would impede the completion of the transaction. An effect of the possible issuance of preferred stock therefore may be to deter a future attempt to gain control of New Waterstone. The board of directors has no present plan or understanding to issue any preferred stock.

Amendments to Articles of Incorporation and Bylaws. Amendments to the articles of incorporation must be approved by the board of directors and by the affirmative vote of at least two-thirds of the outstanding shares of common stock, or by the affirmative vote of a majority of the outstanding shares of common stock if at least two-thirds of the members of the whole board of directors approves such amendment; provided, however, that approval by at least 80% of the outstanding voting stock is generally required to amend certain provisions. A list of these provisions is provided under “Comparison of Stockholders’ Rights For Existing Stockholders of Waterstone Financial, Inc.—Amendment of Governing Instruments” above.

The articles of incorporation also provide that the bylaws may be amended by the affirmative vote of a majority of New Waterstone’s directors or by the stockholders by the affirmative vote of at least 80% of the total votes eligible to be cast at a duly constituted meeting of stockholders. Any amendment of this super-majority requirement for amendment of the bylaws would also require the approval of 80% of the total votes eligible to be cast.

The provisions requiring the affirmative vote of 80% of the total eligible votes eligible to be cast for certain stockholder actions have been included in the articles of incorporation of New Waterstone in reliance on Section 2-104(b)(4) of the Maryland General Corporation Law. Section 2-104(b)(4) permits the articles of incorporation to require a greater proportion of votes than the proportion that would otherwise be required for stockholder action under the Maryland General Corporation Law.

Business Combinations with Interested Stockholders. Maryland law restricts mergers, consolidations, sales of assets and other business combinations between New Waterstone and an “interested stockholder.” See “Comparison of Stockholder Rights for Existing Stockholders of Waterstone Financial, Inc.—Mergers, Consolidations and Sales of Assets” above.

Evaluation of Offers. The articles of incorporation of New Waterstone provide that its board of directors, when evaluating a transaction that would or may involve a change in control of New Waterstone (whether by purchases of its securities, merger, consolidation, share exchange, dissolution, liquidation, sale of all or substantially all of its assets, proxy solicitation or otherwise), may, in connection with the exercise of its business judgment in determining what is in the best interests of New Waterstone and its stockholders and in making any recommendation to the stockholders, give due consideration to all relevant factors, including, but not limited to, certain enumerated factors. For a list of these enumerated factors, see “Comparison of Stockholder Rights for Existing Stockholders of Waterstone Financial, Inc.—Evaluation of Offers” above.

Purpose and Anti-Takeover Effects of New Waterstone’s Articles of Incorporation and Bylaws. Our board of directors believes that the provisions described above are prudent and will reduce our vulnerability to takeover attempts and certain other transactions that have not been negotiated with and approved by our board of directors. These provisions also will assist us in the orderly deployment of the offering proceeds into productive assets during the initial period after the conversion. We believe these provisions are in the best interests of New Waterstone and its stockholders. Our board of directors believes that it will be in the best position to determine the true value of New Waterstone and to negotiate more effectively for what may be in the best interests of all our stockholders. Accordingly, our board of directors believes that it is in the best interests of New Waterstone and all of our stockholders to encourage potential acquirers to negotiate directly with the board of directors and that these provisions will encourage such negotiations and discourage hostile takeover attempts. It is also the view of our board of directors that these provisions should not discourage persons from proposing a merger or other transaction at a price reflective of the true value of New Waterstone and that is in the best interests of all our stockholders.

Takeover attempts that have not been negotiated with and approved by our board of directors present the risk of a takeover on terms that may be less favorable than might otherwise be available. A transaction that is negotiated and approved by our board of directors, on the other hand, can be carefully planned and undertaken at an opportune time in order to obtain maximum value for our stockholders, with due consideration given to matters such as the management and business of the acquiring corporation.

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Although a tender offer or other takeover attempt may be made at a price substantially above the current market price, such offers are sometimes made for less than all of the outstanding shares of a target company. As a result, stockholders may be presented with the alternative of partially liquidating their investment at a time that may be disadvantageous, or retaining their investment in an enterprise that is under different management and whose objectives may not be similar to those of the remaining stockholders.

Despite our belief as to the benefits to stockholders of these provisions of New Waterstone's articles of incorporation and bylaws, these provisions also may have the effect of discouraging a future takeover attempt that would not be approved by our board of directors, but pursuant to which stockholders may receive a substantial premium for their shares over then current market prices. As a result, stockholders who might desire to participate in such a transaction may not have any opportunity to do so. Such provisions will also make it more difficult to remove our board of directors and management. Our board of directors, however, has concluded that the potential benefits outweigh the possible disadvantages.

#### Conversion Regulations

Federal Reserve Board regulations prohibit any person from making an offer, announcing an intent to make an offer or participating in any other arrangement to purchase stock or acquire stock or subscription rights in a converting institution or its holding company from another person prior to completion of its conversion. Further, without the prior written approval of the Federal Reserve Board, no person may make an offer or announcement of an offer to purchase shares or actually acquire shares of a converted institution or its holding company for a period of three years from the date of the completion of the conversion if, upon the completion of such offer, announcement or acquisition, the person would become the beneficial owner of more than 10% of the outstanding stock of the institution or its holding company. The Federal Reserve Board has defined "person" to include any individual, group acting in concert, corporation, partnership, association, joint stock company, trust, unincorporated organization or similar company, a syndicate or any other group formed for the purpose of acquiring, holding or disposing of securities of an insured institution. However, offers made exclusively to a bank or its holding company, or to an underwriter or member of a selling group acting on the converting institution's or its holding company's behalf for resale to the general public, are excepted. The regulation also provides civil penalties for willful violation or assistance in any such violation of the regulation by any person connected with the management of the converting institution or its holding company or who controls more than 10% of the outstanding shares or voting rights of a converted institution or its holding company.

#### Change in Control Regulations

Under the Change in Bank Control Act, no person may acquire control of an insured savings association or its parent holding company unless the Federal Reserve Board has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition. The Federal Reserve Board takes into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. In addition, federal regulations provide that no company may acquire control of a savings association without the prior approval of the Federal Reserve Board. Any company that acquires such control becomes a "savings and loan holding company" subject to registration, examination and regulation by the Federal Reserve Board.

Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the company's directors, or a determination by the Federal Reserve Board that the acquiror has the power to direct, or directly or indirectly to exercise a controlling influence over, the management or policies of the institution. Acquisition of more than 10% of any class of a savings and loan holding company's voting stock constitutes a rebuttable determination of control under

the regulations under certain circumstances including where, as will be the case with New Waterstone, the issuer has registered securities under Section 12 of the Securities Exchange Act of 1934. Federal Reserve Board regulations provide that parties seeking to rebut control will be provided an opportunity to do so in writing.

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DESCRIPTION OF CAPITAL STOCK OF NEW WATERSTONE  
FOLLOWING THE CONVERSION

General

New Waterstone is authorized to issue 100,000,000 shares of common stock, par value of \$0.01 per share, and 50,000,000 shares of preferred stock, par value \$0.01 per share. New Waterstone currently expects to issue in the offering and exchange up to 34,406,929 shares of common stock. New Waterstone will not issue shares of preferred stock in the conversion. Each share of common stock will have the same relative rights as, and will be identical in all respects to, each other share of common stock. Upon payment of the subscription price for the common stock, in accordance with the plan of conversion and reorganization, all of the shares of common stock will be duly authorized, fully paid and nonassessable.

The shares of common stock will represent nonwithdrawable capital, will not be an account of an insurable type, and will not be insured by the Federal Deposit Insurance Corporation or any other government agency.

Common Stock

**Dividends.** New Waterstone may pay dividends to an amount equal to the excess of our capital surplus over payments that would be owed upon dissolution to stockholders whose preferential rights upon dissolution are superior to those receiving the dividend, and to an amount that would not make us insolvent, as and when declared by our board of directors. The payment of dividends by New Waterstone is also subject to limitations that are imposed by law and applicable regulation, including restrictions on payments of dividends that would reduce New Waterstone's assets below the then-adjusted balance of its liquidation account. The holders of common stock of New Waterstone will be entitled to receive and share equally in dividends as may be declared by our board of directors out of funds legally available therefor. If New Waterstone issues shares of preferred stock, the holders thereof may have a priority over the holders of the common stock with respect to dividends.

**Voting Rights.** Upon completion of the conversion, the holders of common stock of New Waterstone will have exclusive voting rights in New Waterstone. They will elect New Waterstone's board of directors and act on other matters as are required to be presented to them under Maryland law or as are otherwise presented to them by the board of directors. Generally, each holder of common stock will be entitled to one vote per share and will not have any right to cumulate votes in the election of directors. Any person who beneficially owns more than 10% of the then-outstanding shares of New Waterstone's common stock, however, will not be entitled or permitted to vote any shares of common stock held in excess of the 10% limit. If New Waterstone issues shares of preferred stock, holders of the preferred stock may also possess voting rights. Certain matters require the approval of 80% of our outstanding common stock.

As a Wisconsin-chartered stock savings bank, corporate powers and control of WaterStone Bank are vested in its board of directors, who elect the officers of WaterStone Bank and who fill any vacancies on the board of directors. Voting rights of WaterStone Bank are vested exclusively in the owners of the shares of capital stock of WaterStone Bank, which will be New Waterstone, and voted at the direction of New Waterstone's board of directors. Consequently, the holders of the common stock of New Waterstone will not have direct control of WaterStone Bank.

**Liquidation.** In the event of any liquidation, dissolution or winding up of WaterStone Bank, New Waterstone, as the holder of 100% of WaterStone Bank's capital stock, would be entitled to receive all assets of WaterStone Bank

available for distribution, after payment or provision for payment of all debts and liabilities of WaterStone Bank, including all deposit accounts and accrued interest thereon, and after distribution of the balance in the liquidation account to Eligible Account Holders and Supplemental Eligible Account Holders. In the event of liquidation, dissolution or winding up of New Waterstone, the holders of its common stock would be entitled to receive, after payment or provision for payment of all its debts and liabilities (including payments with respect to its liquidation account), all of the assets of New Waterstone available for distribution. If preferred stock is issued, the holders thereof may have a priority over the holders of the common stock in the event of liquidation or dissolution.

**Preemptive Rights.** Holders of the common stock of New Waterstone will not be entitled to preemptive rights with respect to any shares that may be issued. The common stock is not subject to redemption.

#### Preferred Stock

None of the shares of New Waterstone's authorized preferred stock will be issued as part of the offering or the conversion. Preferred stock may be issued with preferences and designations as our board of directors may from time to time determine. Our board of directors may, without stockholder approval, issue shares of preferred stock with voting, dividend, liquidation and conversion rights that could dilute the voting strength of the holders of the common stock and may assist management in impeding an unfriendly takeover or attempted change in control.

#### TRANSFER AGENT

The transfer agent and registrar for New Waterstone's common stock is Broadridge Corporate Issuer Solutions, Inc., Brentwood, New York.

#### EXPERTS

The consolidated financial statements of Waterstone-Federal and subsidiaries as of December 31, 2012 and 2011, and for each of the years in the three-year period ended December 31, 2012, and management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2012, have been included herein and in the registration statement in reliance upon the reports of KPMG LLP, independent registered public accounting firm, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing.

RP Financial, LC. has consented to the publication herein of the summary of its report setting forth its opinion as to the estimated pro forma market value of the shares of common stock upon completion of the conversion and offering and its letters with respect to subscription rights and the liquidation accounts.

#### LEGAL MATTERS

Luse Gorman Pomerenk & Schick, P.C., Washington, D.C., counsel to New Waterstone, Lamplighter Financial, MHC, Waterstone-Federal and WaterStone Bank, has issued to New Waterstone its opinion regarding the legality of the common stock and the federal income tax consequences of the conversion. Baker Tilly Virchow Krause, LLP has provided an opinion to us regarding the Wisconsin income tax consequences of the conversion. Certain legal matters will be passed upon for Sandler O'Neill & Partners, L.P. and, in the event of a syndicated or firm commitment underwritten offering, for the other co-managers, by Kilpatrick Townsend & Stockton LLP, Washington, D.C.

#### WHERE YOU CAN FIND ADDITIONAL INFORMATION

New Waterstone has filed with the Securities and Exchange Commission a registration statement under the Securities Act of 1933 with respect to the shares of common stock offered hereby. As permitted by the rules and regulations of the Securities and Exchange Commission, this proxy statement/prospectus does not contain all the information set forth in the registration statement. Such information, including the appraisal report which is an exhibit to the registration statement, can be examined without charge at the public reference facilities of the Securities and Exchange Commission located at 100 F Street, N.E., Washington, D.C. 20549, and copies of such material can be obtained from the Securities and Exchange Commission at prescribed rates. The Securities and Exchange



Commission telephone number is 1-800-SEC-0330. In addition, the Securities and Exchange Commission maintains a web site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Securities and Exchange Commission, including New Waterstone. The statements contained in this proxy statement/prospectus as to the contents of any contract or other document filed as an exhibit to the registration statement are, of necessity, brief descriptions of the material terms of, and should be read in conjunction with, such contract or document.

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Lamplighter Financial, MHC has filed with the Board of Governors of the Federal Reserve System an Application on Form AC with respect to the conversion, and New Waterstone has filed with the Board of Governors of the Federal Reserve System an Application H-(e)1 with respect to its acquisition of WaterStone Bank. This proxy statement/prospectus omits certain information contained in those applications. To obtain a copy of the applications filed with the Board of Governors of the Federal Reserve System, you may contact Ms. Colette A. Fried, Assistant Vice President of the Federal Reserve Bank of Chicago, at (312) 322-6846. The Plan of Conversion and Reorganization is available, upon request, at each of WaterStone Bank's offices.

In connection with the offering, New Waterstone will register its common stock under Section 12(b) of the Securities Exchange Act of 1934 and, upon such registration, New Waterstone and the holders of its common stock will become subject to the proxy solicitation rules, reporting requirements and restrictions on common stock purchases and sales by directors, officers and greater than 10% stockholders, the annual and periodic reporting and certain other requirements of the Securities Exchange Act of 1934. Under the plan of conversion and reorganization, New Waterstone has undertaken that it will not terminate such registration for a period of at least three years following the offering.

#### STOCKHOLDER PROPOSALS

In order to be eligible for inclusion in our proxy materials for our 2014 Annual Meeting of Stockholders, any stockholder proposal to take action at such meeting must be received at our executive office, 11200 West Plank Court, Wauwatosa, Wisconsin 53226, no later than December 2, 2013. Any such proposals shall be subject to the requirements of the proxy rules adopted under the Exchange Act.

#### ADVANCE NOTICE OF BUSINESS TO BE CONDUCTED AT AN ANNUAL MEETING

Provisions of Waterstone-Federal's Bylaws. Under Waterstone-Federal's Bylaws, a stockholder must follow certain procedures to nominate persons for election as directors or to introduce an item of business at a meeting of stockholders. These procedures provide, generally, that stockholders desiring to make nominations for directors, or to bring a proper subject of business before the meeting, must do so by a written notice timely received (generally not less than 30 days in advance of such meeting, subject to certain exceptions) by the Secretary of Waterstone-Federal.

Provisions of New Waterstone's Bylaws. New Waterstone's Bylaws provide an advance notice procedure for certain business, or nominations to the Board of Directors, to be brought before an annual meeting of shareholders. In order for a shareholder to properly bring business before an annual meeting, or to propose a nominee to the board of directors, New Waterstone's Secretary must receive written notice not earlier than the 90th day nor later than the 80th day prior to date of the annual meeting; provided, however, that in the event that less than 90 days' notice or prior public disclosure of the date of the annual meeting is provided to shareholders, then, to be timely, notice by the shareholder must be so received not later than the tenth day following the day on which public announcement of the date of such meeting is first made.

The notice with respect to shareholder proposals that are not nominations for director must set forth as to each matter such shareholder proposes to bring before the annual meeting: (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting; (ii) the name and address of such shareholder as they appear on New Waterstone's books and of the beneficial owner, if any, on whose behalf the proposal is made; (iii) the class or series and number of shares of capital stock of New Waterstone which are owned beneficially or of record by such shareholder and such beneficial owner; (iv) a description of all arrangements or understandings between such shareholder and any other person or persons (including their names) in connection with the proposal of such business by such shareholder and any material interest of such shareholder in

such business; and (v) a representation that such shareholder intends to appear in person or by proxy at the annual meeting to bring such business before the meeting.

The notice with respect to director nominations must include (i) as to each individual whom the shareholder proposes to nominate for election as a director, (A) all information relating to such person that would indicate such

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person's qualification under Article 2, Section 12 of New Waterstone's Bylaws, including an affidavit that such person would not be disqualified under the provisions of Article 2, Section 12 of the Bylaws and (B) all other information relating to such individual that is required to be disclosed in connection with solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, or any successor rule or regulation; and (ii) as to the shareholder giving the notice, (A) the name and address of such shareholder as they appear on New Waterstone's books and of the beneficial owner, if any, on whose behalf the nomination is made; (B) the class or series and number of shares of capital stock of New Waterstone which are owned beneficially or of record by such shareholder and such beneficial owner; (C) a description of all arrangements or understandings between such shareholder and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made by such shareholder; (D) a representation that such shareholder intends to appear in person or by proxy at the meeting to nominate the persons named in its notice; and (E) any other information relating to such shareholder that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors pursuant to Regulation 14A under the Securities Exchange Act of 1934 or any successor rule or regulation. Such notice must be accompanied by a written consent of each proposed nominee to be named as a nominee and to serve as a director if elected.

The 2014 annual meeting of stockholders is expected to be held May 20, 2014. If the conversion is completed, advance written notice for certain business, or nominations to the Board of Directors, to be brought before the next annual meeting must be given to us no later than March 31, 2014. If notice is received after March 31, 2014, it will be considered untimely, and we will not be required to present the matter at the stockholders meeting. If the conversion is not completed, advance written notice for certain business, or nominations to the Board of Directors, to be brought before the next annual meeting must be given to us by April 20, 2014. If notice is received after April 20, 2014, it will be considered untimely, and we will not be required to present the matter at the stockholders meeting.

Nothing in this proxy statement/prospectus shall be deemed to require us to include in our proxy statement and proxy relating to an annual meeting any stockholder proposal that does not meet all of the requirements for inclusion established by the Securities and Exchange Commission in effect at the time such proposal is received.

#### IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE SPECIAL MEETING

The Notice of Special Meeting of Stockholders, Proxy Statement/Prospectus and Proxy Card are available at [www.proxyvote.com](http://www.proxyvote.com).

#### OTHER MATTERS

As of the date of this document, the board of directors is not aware of any business to come before the special meeting other than the matters described above in the proxy statement/prospectus. However, if any matters should properly come before the special meeting, it is intended that the holders of the proxies will act in accordance with their best judgment.

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All financial statement schedules have been omitted as the required information either is not applicable or is included in the financial statements or related notes.

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WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	(Unaudited)	
	June 30, 2013	December 31, 2012
	(In Thousands, except share data)	
Assets		
Cash	\$40,319	37,129
Federal funds sold	13,803	28,576
Interest-earning deposits in other financial institutions and other short term investments	246	5,764
Cash and cash equivalents	54,368	71,469
Securities available for sale (at fair value)	216,253	205,017
Loans held for sale (at fair value)	132,045	133,613
Loans receivable	1,106,915	1,133,672
Less: Allowance for loan losses	27,767	31,043
Loans receivable, net	1,079,148	1,102,629
Office properties and equipment, net	27,781	26,935
Federal Home Loan Bank stock (at cost)	20,193	20,193
Cash surrender value of life insurance	38,642	38,061
Real estate owned	29,983	35,974
Prepaid expenses and other assets	34,463	27,185
Total assets	\$1,632,876	1,661,076
Liabilities and Shareholders' Equity		
Liabilities:		
Demand deposits	\$91,496	84,140
Money market and savings deposits	119,620	118,453
Time deposits	681,891	736,920
Total deposits	893,007	939,513
Short-term borrowings	56,046	45,888
Long-term borrowings	434,000	434,000
Advance payments by borrowers for taxes	15,556	1,672
Other liabilities	24,922	37,369
Total liabilities	1,423,531	1,458,442
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 2013 and 2012		
Issued - 34,074,450 in 2013 and 34,072,909 in 2012		
Outstanding - 31,349,317 in 2013 and 31,348,556 in 2012	341	341
Additional paid-in capital	110,438	110,490
Retained earnings	146,039	136,487

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Unearned ESOP shares	(1,280 )	(1,708 )
Accumulated other comprehensive (loss) income, net of taxes	(932 )	2,285
Treasury shares (2,724,353 shares), at cost	(45,261 )	(45,261 )
Total shareholders' equity	209,345	202,634
Total liabilities and shareholders' equity	\$1,632,876	1,661,076

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

	Three months ended June 30, 2013		Six months ended June 30, 2013	
	2012	2013	2012	2013
(In Thousands, except per share amounts)				
Interest income:				
Loans	\$14,862	16,319	30,075	32,892
Mortgage-related securities	419	921	856	1,784
Debt securities, federal funds sold and short-term investments	617	548	1,153	1,255
Total interest income	15,898	17,788	32,084	35,931
Interest expense:				
Deposits	1,353	2,663	2,819	5,866
Borrowings	4,624	4,497	9,198	9,010
Total interest expense	5,977	7,160	12,017	14,876
Net interest income	9,921	10,628	20,067	21,055
Provision for loan losses	1,200	1,425	2,960	5,100
Net interest income after provision for loan losses	8,721	9,203	17,107	15,955
Noninterest income:				
Service charges on loans and deposits	348	382	713	631
Increase in cash surrender value of life insurance	261	264	401	409
Total other-than-temporary investment losses	—	(471 )	—	(475 )
Portion of loss recognized in other comprehensive income (before income taxes)	—	371	—	371
Net impairment losses recognized in earnings	—	(100 )	—	(104 )
Mortgage banking income	25,455	22,507	47,443	36,708
(Loss) gain on sale of available for sale securities	—	—	(9 )	241
Other	643	199	1,192	368
Total noninterest income	26,707	23,252	49,740	38,253
Noninterest expenses:				
Compensation, payroll taxes, and other employee benefits	19,944	14,965	36,426	25,602
Occupancy, office furniture, and equipment	1,862	1,688	3,778	3,409
Advertising	796	769	1,620	1,324
Data processing	484	334	961	726
Communications	342	306	750	603
Professional fees	730	533	1,135	959
Real estate owned	12	2,838	153	4,273
FDIC insurance premiums	380	873	1,053	1,814
Other	2,897	3,930	5,442	7,041
Total noninterest expenses	27,447	26,236	51,318	45,751
Income before income taxes	7,981	6,219	15,529	8,457
Income tax expense	3,054	41	5,977	71

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Net income	\$4,927	6,178	9,552	8,386
Income per share:				
Basic	\$0.16	0.20	0.31	0.27
Diluted	\$0.16	0.20	0.30	0.27
Weighted average shares outstanding:				
Basic	31,144	31,045	31,134	31,035
Diluted	31,368	31,136	31,351	31,069

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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WATERSONE FINANCIAL, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
	(In Thousands)			
Net income	\$4,927	6,178	9,552	8,386
Other comprehensive income, net of tax:				
Net unrealized holding (loss) gain on available for sale securities:				
Net unrealized holding (loss) gain arising during the period, net of tax benefit (expense) of \$1,895, (\$320), \$2,120, (\$420), respectively	(2,881)	582	(3,222)	922
Reclassification adjustment for net loss (gain) included in net income during the period, net of tax (benefit) expense of \$0, (\$41),(\$4), \$55, respectively	-	63	5	(81 )
Total other comprehensive (loss) income	(2,881)	645	(3,217)	841
Comprehensive income	\$2,046	6,823	6,335	9,227

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock Shares	Additional Paid-In Capital Amount	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income (Loss)	Treasury Shares	Total Shareholders' Equity	
Balances at December 31, 2011	31,250	\$ 340	110,894	101,573	(2,562 )	1,388	(45,261 )	166,372
Comprehensive income:								
Net income	—	—	—	8,386	—	—	—	8,386
Other comprehensive income	—	—	—	—	—	841	—	841
Total comprehensive income								9,227
ESOP shares committed to be released to Plan participants	—	—	(317 )	—	427	—	—	110
Stock based compensation	100	—	75	—	—	—	—	75
Balances at June 30, 2012	31,350	\$ 340	110,652	109,959	(2,135 )	2,229	(45,261 )	175,784
Balances at December 31, 2012	31,348	\$ 341	110,490	136,487	(1,708 )	2,285	(45,261 )	202,634
Comprehensive income:								
Net income	—	—	—	9,552	—	—	—	9,552
Other comprehensive loss	—	—	—	—	—	(3,217 )	—	(3,217 )
Total comprehensive income								6,335
ESOP shares committed to be released to Plan participants	—	—	(117 )	—	428	—	—	311
Stock based compensation	1	—	65	—	—	—	—	65
Balances at June 30, 2013	31,349	\$ 341	110,438	146,039	(1,280 )	(932 )	(45,261 )	209,345

See Accompanying Notes to Unaudited Consolidated Financial Statements.

WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Six months ended June 30	
	2013	2012
	(In Thousands)	
Operating activities:		
Net income	\$9,552	8,386
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,960	5,100
Provision for depreciation	1,226	985
Deferred income taxes	3,624	(2,160 )
Stock based compensation	65	75
Net amortization of premium/discount on debt and mortgage related securities	1,233	576
Amortization of unearned ESOP shares	311	110
Gain on sale of loans held for sale	(43,399 )	(37,304 )
Loans originated for sale	(978,327 )	(767,092)
Proceeds on sales of loans originated for sale	1,023,294	770,190
(Increase) decrease in accrued interest receivable	(395 )	508
Increase in cash surrender value of life insurance	(401 )	(409 )
Decrease in accrued interest on deposits and borrowings	(135 )	(318 )
Increase in other liabilities	1,754	3,862
Decrease in accrued tax payable	(2,190 )	(257 )
Loss (gain) on sale of available for sale securities	9	(241 )
Impairment of securities	-	104
Net (gain) loss related to real estate owned	(802 )	2,670
Other	(7,660 )	(2,887 )
Net cash provided by (used in) operating activities	10,719	(18,102 )
Investing activities:		
Net decrease in loans receivable	12,117	33,609
Purchases of:		
Debt securities	(34,555 )	-
Mortgage related securities	(7,160 )	(77,252 )
Certificates of deposit	(980 )	(1,470 )
Premises and equipment, net	(2,093 )	(741 )
Bank owned life insurance	(180 )	(180 )
Proceeds from:		
Principal repayments on mortgage-related securities	21,902	16,182
Maturities of debt securities	2,060	11,908
Sales of debt securities	921	44,868
Calls of structured notes	-	2,648
Sales of real estate owned	14,466	16,247

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Redemption of FHLB stock	-	1,146
Net cash provided by investing activities	6,498	46,965

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WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)

	Six months ended June 30	
	2013	2012
	(In Thousands)	
Financing activities:		
Net decrease in deposits	(46,506)	(65,094)
Net increase in short-term borrowings	10,158	17,893
Net increase in advance payments by borrowers for taxes	2,030	2,833
Net cash used in financing activities	(34,318)	(44,368)
Decrease in cash and cash equivalents	(17,101)	(15,505)
Cash and cash equivalents at beginning of period	71,469	80,380
Cash and cash equivalents at end of period	54,368	64,875
Supplemental information:		
Cash paid or credited during the period for:		
Income tax payments	4,573	2,488
Interest payments	12,151	15,195
Noncash investing activities:		
Loans receivable transferred to real estate owned	8,404	11,002

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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WATERSTONE FINANCIAL, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1 — Basis of Presentation

The unaudited interim consolidated financial statements include the accounts of Waterstone Financial, Inc. (the “Company”) and the Company’s subsidiaries.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information, Rule 10-01 of Regulation S-X and the instructions to Form 10-Q. The financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position, results of operations, changes in shareholders’ equity, and cash flows of the Company for the periods presented.

The accompanying unaudited consolidated financial statements and related notes should be read in conjunction with the Company’s December 31, 2012 Annual Report on Form 10-K. Operating results for the six and three months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or for any other period.

The preparation of the unaudited 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 and real estate owned. Actual results could differ from those estimates.



## Note 2— Securities Available for Sale

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

	June 30, 2013			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In Thousands)			
Mortgage-backed securities	\$107,683	1,229	(694 )	108,218
Collateralized mortgage obligations:				
Government sponsored enterprise issued	22,465	329	—	22,794
Mortgage-related securities	130,148	1,558	(694 )	131,012
Government sponsored enterprise bonds	14,517	3	(175 )	14,345
Municipal securities	61,173	1,072	(2,677 )	59,568
Other debt securities	5,000	168	—	5,168
Debt securities	80,690	1,243	(2,852 )	79,081
Certificates of Deposit	6,125	43	(8 )	6,160
	\$216,963	2,844	(3,554 )	216,253
	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

The Company's mortgage-backed securities and collateralized mortgage obligations issued by government sponsored enterprises are guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. At June 30, 2013, \$989,000 of the Company's government sponsored enterprise bonds and \$100.5 million of the Company's mortgage related securities were pledged as collateral to secure repurchase agreement obligations of the Company.

The amortized cost and fair values of investment securities by contractual maturity at June 30, 2013 are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Debt and other securities		
Due within one year	\$2,355	2,359
Due after one year through five years	28,704	29,341
Due after five years through ten years	20,792	19,866
Due after ten years	34,964	33,675
Mortgage-related securities	130,148	131,012
	\$216,963	216,253

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:

	June 30, 2013					
	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	\$49,739	(694 )	—	—	49,739	(694 )
Government sponsored enterprise bonds	10,842	(175 )	—	—	10,842	(175 )
Municipal securities	41,912	(2,535 )	337	(142 )	42,249	(2,677 )
Certificates of Deposit	1,216	(8 )	—	—	1,216	(8 )
	\$103,709	(3,412 )	337	(142 )	104,046	(3,554 )

	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 )

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.

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As of June 30, 2013, 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. No additional credit loss was recognized during the six months ended June 30, 2013. As of June 30, 2013, these securities had a combined amortized cost of \$215,000 and a combined estimated fair value of \$189,000. As of June 30, 2013, 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 June 30, 2013. During the year ended December 31, 2012, two private-label collateralized mortgage obligations, that had been identified as other than temporarily impaired, 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.

The following table presents the change in other-than-temporary credit related impairment charges on securities available for sale 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, 2011	\$ 2,096
Credit-related impairments related to securities for which an 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 was previously recognized	(2,209 )
Credit-related impairments on securities as of December 31, 2012	100
Credit-related impairments related to securities for which an 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	—
Credit-related impairments on securities as of June 30, 2013	\$ 100

Exclusive of the aforementioned securities, the Company has determined that the decline in fair value of the remaining securities is not attributable to credit deterioration. Based on the foregoing evaluation criteria, 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.

During the six months ended June 30, 2013, proceeds from the sale of securities totaled \$921,000 and resulted in losses totaling \$9,000. The \$9,000 loss included in (loss) gain on sale of available for sale securities in the consolidated statements of income during the six months ended June 30, 2013 was reclassified from accumulated other comprehensive income. During the six months ended June 30, 2012, proceeds from the sale of securities totaled \$11.9 million and resulted in gains totaling \$241,000. The \$241,000 gain included in (loss) gain on sale of available for sale securities in the consolidated statements of income during the six months ended June 30, 2012 was reclassified from accumulated other comprehensive income.

### Note 3 - Loans Receivable

Loans receivable at June 30, 2013 and December 31, 2012 are summarized as follows:

	June 30, 2013	December 31, 2012
	(In Thousands)	
Mortgage loans:		
Residential real estate:		
One- to four-family	\$425,693	460,821
Over four-family	518,745	514,363
Home equity	35,382	36,494
Construction and land	36,981	33,818
Commercial real estate	70,960	65,495
Consumer	134	132
Commercial loans	19,020	22,549
	\$1,106,915	1,133,672

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 are geographically concentrated in the Company's Milwaukee metropolitan area, and while 88.5% 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 residential in nature, it ranges from owner-occupied single family homes to large apartment complexes. In addition, real estate collateralizing \$74.6 million, or 6.7% of total loans, is located outside of the state of Wisconsin.

During the six months ended June 30, 2013, \$978.3 million in residential loans were originated for sale. During the same period, sales of loans held for sale totaled \$1.0 billion, generating mortgage banking income of \$47.4 million. The unpaid principal balance of loans serviced for others was \$943.6 million and \$635.8 million at June 30, 2013 and December 31, 2012, respectively. These loans are not reflected in the consolidated statements of financial condition.

Qualifying loans receivable totaling \$792.8 million and \$801.6 million at June 30, 2013 and December 31, 2012, respectively, are pledged as collateral against \$350.0 million in outstanding Federal Home Loan Bank of Chicago

advances under a blanket security agreement.

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An analysis of past due loans receivable as of June 30, 2013 and December 31, 2012 follows:

	As of June 30, 2013			Total Past Due	Current (3)	Total Loans
	1-59 Days Past Due (1)	60-89 Days Past Due (2)	Greater Than 90 Days			
(In Thousands)						
Mortgage loans:						
Residential real estate:						
One- to four-family	\$8,371	6,126	20,971	35,468	390,225	425,693
Over four-family	1,691	1,200	8,427	11,318	507,427	518,745
Home equity	1,471	143	206	1,820	33,562	35,382
Construction and land	5,476	1,995	3,170	10,641	26,340	36,981
Commercial real estate	576	—	272	848	70,112	70,960
Consumer	—	—	—	—	134	134
Commercial loans	—	—	511	511	18,509	19,020
Total	\$17,585	9,464	33,557	60,606	1,046,309	1,106,915

As of December 31, 2012

Mortgage loans:						
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

(1) Includes \$3.6 million and \$2.4 million for June 30, 2013 and December 31, 2012, respectively, which are on non-accrual status.

(2) Includes \$6.2 million and \$2.8 million for June 30, 2013 and December 31, 2012, respectively, which are on non-accrual status.

(3) Includes \$9.9 million and \$18.2 million for June 30, 2013 and December 31, 2012, respectively, which are on non-accrual status.

As of June 30, 2013 and December 31, 2012, there are no loans that are 90 or more days past due and still accruing interest.

A summary of the activity for the six months ended June 30, 2013 and 2012 in the allowance for loan losses follows:

	One- to Four- Family (In Thousands)	Over Four- Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
Six months ended June 30, 2013								
Balance at beginning of period	\$17,819	7,734	2,097	1,323	1,259	30	781	31,043
Provision (credit) for loan losses	2,115	(335 )	163	926	110	3	(22 )	2,960
Charge-offs	(5,686 )	(732 )	(524 )	(134 )	(95 )	—	—	(7,171 )
Recoveries	608	201	70	51	—	2	3	935
Balance at end of period	\$14,856	6,868	1,806	2,166	1,274	35	762	27,767
Six months ended June 30, 2012								
Balance at beginning of period	\$17,475	8,252	1,998	2,922	941	28	814	32,430
Provision (credit) for loan losses	2,943	1,396	374	(137 )	817	(1 )	(292 )	5,100
Charge-offs	(4,133 )	(612 )	(158 )	(192 )	(43 )	—	(59 )	(5,197 )
Recoveries	252	11	22	15	—	—	25	325
Balance at end of period	\$16,537	9,047	2,236	2,608	1,715	27	488	32,658

A summary of the allowance for loan loss for loans evaluated individually and collectively for impairment by collateral class as of June 30, 2013 follows:

	One- to Four- Family (In Thousands)	Over Four Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
Allowance related to loans individually evaluated for impairment	\$3,850	786	863	377	218	—	376	6,470
Allowance related to loans collectively evaluated for impairment	11,006	6,082	943	1,789	1,056	35	386	21,297
Balance at end of period	\$14,856	6,868	1,806	2,166	1,274	35	762	27,767
Loans individually evaluated for impairment	\$46,925	25,940	1,885	6,689	436	20	1,352	83,247
Loans collectively evaluated for impairment	378,768	492,805	33,497	30,292	70,524	114	17,668	1,023,668
Total gross loans	\$425,693	518,745	35,382	36,981	70,960	134	19,020	1,106,915





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 (In Thousands)	Over Four Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
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

The following table presents information relating to the Company's internal risk ratings of its loans receivable as of June 30, 2013 and December 31, 2012:

	One- to Four- Family (In Thousands)	Over Four Family	Home Equity	Construction and Land	Commercial Real Estate	Consumer	Commercial	Total
At June 30, 2013								
Substandard	\$42,846	10,468	2,263	6,689	437	20	1,364	64,087
Watch	12,937	26,836	985	2,015	1,997	—	1,294	46,064
Pass	369,910	481,441	32,134	28,277	68,526	114	16,362	996,764
	\$425,693	518,745	35,382	36,981	70,960	134	19,020	1,106,915
At December 31, 2012								
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

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 approve 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. An additional adjustment factor is applied by appraisal vintage 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 June 30, 2013 and December 31, 2012.

	As of or for the Six Months Ended June 30, 2013					
	Recorded Investment	Unpaid Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid
	(In Thousands)					
<b>Total Impaired with Reserve</b>						
One- to four-family	\$19,634	20,299	3,850	665	20,513	373
Over four-family	22,570	22,955	786	385	24,054	254
Home equity	1,353	1,353	863	—	1,440	25
Construction and land	1,551	1,551	377	—	1,551	23
Commercial real estate	349	759	218	409	758	5
Consumer	—	—	—	—	—	—
Commercial	1,352	1,352	376	—	1,352	18
	46,809	48,269	6,470	1,459	49,668	698
<b>Total Impaired with no Reserve</b>						
One- to four-family	27,291	32,111	—	4,819	31,856	608
Over four-family	3,370	3,859	—	489	3,880	59
Home equity	532	532	—	—	542	8
Construction and land	5,138	6,603	—	1,465	6,605	47
Commercial real estate	87	163	—	76	175	2
Consumer	20	20	—	—	22	—
Commercial	—	—	—	—	—	—
	36,438	43,288	—	6,849	43,080	724
<b>Total Impaired</b>						
One- to four-family	46,925	52,410	3,850	5,484	52,369	981
Over four-family	25,940	26,814	786	874	27,934	313
Home equity	1,885	1,885	863	—	1,982	33
Construction and land	6,689	8,154	377	1,465	8,156	70
Commercial real estate	436	922	218	485	933	7
Consumer	20	20	—	—	22	—
Commercial	1,352	1,352	376	—	1,352	18
	\$83,247	91,557	6,470	8,308	92,748	1,422

As of or for the Year Ended December 31, 2012

	Recorded Unpaid Investment Principal	Reserve	Cumulative Charge-Offs	Average Recorded Investment	Interest Paid	
(In Thousands)						
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				