

HOPFED BANCORP INC  
Form 10-K  
March 09, 2016

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

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

**For the fiscal year ended December 31, 2015**

**Commission file number 000-23667**

**HOPFED BANCORP, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State of jurisdiction of incorporation or organization)**

**61-1322555**  
**(I.R.S. Employer Identification No.)**

**4155 Lafayette Road, Hopkinsville, KY**  
**(Address of principal executive offices)**

**42240**  
**(Zip Code)**

**Registrant's telephone number, including area code: (270) 885-1171.**

**Securities registered pursuant to Section 12(b) of the Act: None.**

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

**Common Stock, par value \$.01 per share**

**(Title of Class)**

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

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

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

YES ☒ NO ☐

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (as defined in Rule 12b-2 of the Act).

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Small Reporting Company ☐

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

The registrant's voting stock is traded on the NASDAQ Stock Market. The aggregate market value of the voting stock held by non-affiliates of the registrant, computed by reference to the price (\$11.83 per share) at which the stock was sold on June 30, 2015, was approximately \$78,752,393. For purposes of this calculation, the term "affiliate" refers to all executive officers and directors of the registrant and all stockholders beneficially owning more than 10% of the registrant's Common Stock.

As of the close of business on March 1, 2016, 6,842,785 shares of the registrant's Common Stock were outstanding.

**Documents Incorporated By Reference**

**Part II:**

Annual Report to Stockholders for the year ended December 31, 2015.

Part III:

Portions of the definitive proxy statement for the 2016 Annual Meeting of Stockholders.

## PART I

### ITEM 1. BUSINESS

In February 1998, HopFed Bancorp, Inc. (the Company) issued and sold 4,033,625 shares of common stock, par value \$.01 per share (the Common Stock), in connection with the conversion of Hopkinsville Federal Savings Bank (the Bank) from a federal mutual savings bank to a federal stock savings bank and the issuance of the Bank's capital stock to the Company. The conversion of the Bank, the acquisition of all of the outstanding capital stock of the Bank by the Company and the issuance and sale of the Common Stock are collectively referred to herein as the Conversion. In June of 2010, the Company issued and sold 3,333,334 shares of common stock, par value \$0.01 per share in connection with a common stock offering. In July 2010, the Company issued and sold an additional 250,000 shares of common stock. Both sales were completed at an offering price of \$9.00 per share (\$8.55 net of expenses). After underwriting fees and selling expenses, the Company received additional capital proceeds of approximately \$30.4 million. The consolidated results of the Bank and the Company are referred to as the Company.

#### **HopFed Bancorp, Inc.**

HopFed Bancorp, Inc. was incorporated under the laws of the State of Delaware in May 1997 at the direction of the Board of Directors of the Bank for the purpose of serving as a savings and loan holding company of the Bank upon the acquisition of all of the capital stock issued by the Bank in the Conversion. On June 5, 2013, the Company's bank subsidiary, Heritage Bank, changed its name to Heritage Bank USA, Inc., (the Bank), converting its charter from a federal thrift to a Kentucky state chartered commercial bank. Likewise, the Company's charter was converted to a Federal Reserve non-member commercial bank holding company. The Company's assets primarily consist of the outstanding capital stock of the Bank. The Company's principal business is overseeing the business of the Bank. See Regulation Regulation of the Company. As a holding company, the Company has greater flexibility than the Bank to diversify its business activities through existing or newly formed subsidiaries or through acquisition or merger with other financial institutions. The Company's executive offices are located at 4155 Lafayette Road, Hopkinsville, Kentucky 42240, and its main telephone number is (270) 885-1171. The Company's mailing address is P.O. Box 537, Hopkinsville, Kentucky 42241-0537.

#### **Heritage Bank USA, Inc.**

The Bank is a Kentucky state chartered commercial bank headquartered in Hopkinsville, Kentucky, with branch offices in Kentucky and Tennessee. The Kentucky locations include Hopkinsville, Murray, Cadiz, Elkton, Fulton, Calvert City and Benton. The Tennessee locations include Clarksville, Pleasant View, Ashland City, Kingston Springs and Erin. In October 2014, the Bank opened a loan production office in Nashville, Tennessee. The Bank was incorporated by the Commonwealth of Kentucky in 1879 under the name Hopkinsville Building and Loan Association. In 1940, the Bank converted to a federal mutual savings association and received federal insurance of its deposit accounts. In 1983, the Bank became a federal mutual savings bank. On May 14, 2002, the Bank changed its name from Hopkinsville Federal Bank to Heritage Bank. On June 5, 2013, the Bank's legal name was changed to Heritage Bank USA, Inc. The primary market area of the Bank consists of the adjacent counties of Calloway, Christian, Todd, Trigg, Fulton, and Marshall located in southwestern Kentucky and Montgomery, Cheatham, Houston, Davidson, Obion and Weakley counties located in Tennessee.

The business of the Bank primarily consists of attracting deposits from the general public and investing such deposits in loans secured by single family residential real estate and investment securities, including U.S. Government and agency securities, municipal and corporate bonds, collateralized mortgages obligations (CMOs), and mortgage-backed securities. The Bank also originates single-family residential/construction loans and multi-family and commercial real estate loans, as well as loans secured by deposits, other consumer loans and commercial loans. The Bank emphasizes

the origination of residential real estate loans with adjustable interest rates and other assets which are responsive to changes in interest rates and allow the Bank to more closely match the interest rate maturation of its assets and liabilities.

The following chart outlines the Bank's market share in its six largest markets individually at June 30, 2011, 2012, 2013, 2014 and 2015, according to information provided by the FDIC market Share Report:

	At June 30				
	2011	2012	2013	2014	2015
Calloway	16.2%	15.3%	14.1%	13.7%	13.2%
Christian	26.2%	22.5%	22.1%	22.6%	20.0%
Fulton	56.4%	53.9%	52.0%	51.0%	49.1%
Marshall	15.0%	14.9%	12.9%	11.9%	10.6%
Cheatham	16.9%	17.8%	18.9%	20.0%	23.4%
Montgomery	3.0%	3.0%	2.6%	2.5%	2.7%

### **Growth Opportunities**

For the year ended December 31, 2015, the Company's net loan portfolio balance was \$556.3 million compared to \$539.3 million at December 31, 2014. In October 2014, the Company opened a loan production office in Nashville, Tennessee. Nashville is approximately 70 miles from the Company's headquarters and one of the fastest growing markets in the country. The Company seeks to establish a successful loan production office and use that success to build a modest branch network into the suburban areas surrounding Nashville. As the demographic information on pages five and six suggest, the Nashville metropolitan area provides the Company with an unlimited amount of growth opportunities not found in our more rural markets. At December 31, 2015, the Company has approximately \$15.4 million in loans outstanding from our loan production office.

The Company's 2015 loan portfolio growth of \$17.0 million, or 3.2%, was preceded by negative loan growth in four of the last five years. The negative loan growth was the result of several factors, including the deployment of more than 15,000 troops from nearby Fort Campbell, Kentucky to Afghanistan resulted in a reduced level of economic activity, lower sales for merchants, weaker demand for most goods and services and reduced tax collections. Furthermore, the deployment of troops occurred during a time of a national recession, further exasperating the weakness in the local economy.

Another important factor inhibiting lending growth prior to 2013 was the presence of a Memorandum of Understanding and Agreement (MOU) originally between the Board of Directors of the Corporation, Board of Directors of the Bank and the OTS, the Company's and Banks former regulator. The MOU required the Bank to limit the growth of specific types of lending, including commercial real estate lending. In 2010 and 2011, the MOU's limitation on commercial real estate made it more difficult for the Bank to experience positive loan growth. The MOU's limitation on commercial real estate lending was focused on the OTS definition of commercial real estate loan concentrations. In October 2012, the Office of the Comptroller of the Currency (OCC) terminated the Bank's MOU.

The Company has chosen not to seek land development loans to augment loan growth. At December 31, 2009, total land loans were \$64.5 million, as compared to \$22.5 million at December 31, 2015. At December 31, 2015, the Company has \$10.6 million in land development loans classified as substandard, representing 37.8% of all substandard loans and 47.3% of total land development loans. At December 31, 2015, the Company has chosen not to incur the additional risk associated with these types of lending relationships and remains committed to resolving the small number of adversely classified loans in our portfolio.

In response to the decline in loan demand, the Company sought to reduce the size of its balance sheet and its cost interest bearing liabilities. At April 30, 2010, the Company had brokered deposits totaling \$104.0 million as compared to \$34.4 million at December 31, 2015. The Company has also reduced the balance of Federal Home Loan Bank (FHLB) borrowings from \$81.9 million at December 31, 2010, to \$15.0 million at December 31, 2015. The reduction

of FHLB borrowings include early repayments of \$35.9 million in borrowings on December 30, 2014, resulting in \$2.5 million prepayment penalty.

In addition to reducing the level of wholesale funding, the Company's funding mix has significantly improved, resulting in lower level of interest expenses. At December 31, 2015, total time deposits (including brokered) were \$314.7 million, a decline of \$17.2 million and \$67.3 million as compared to December 31, 2014, and December 31, 2013, respectively. At December 31, 2015, the Company's time deposit balances accounted for 42.6% of total deposits as compared to 45.4% of total deposits at December 31, 2014, and 50.1% at December 31, 2013.

The Company's opportunities for improved profitability lie in a balanced growth of loans and lower cost deposits while maintaining acceptable credit standards. The Company views its core markets of Western Kentucky and Middle Tennessee as important foundations to our future. The Nashville, Tennessee, market appears to provide the Company with the best opportunity for meaningful loan growth in the near future.

### Western Kentucky

Small manufacturing and agri-business interest are the largest drivers of the local economy in our western Kentucky markets. In Western Kentucky, small manufacturing typically revolves around the automotive, transportation, and chemical industries. The manufacturing sector is reasonably strong in the immediate area with most factories running at least two shifts. Unemployment rates are improved significantly in Western Kentucky due largely to the rebound in automobile sales.

In 2015, local farmers enjoyed strong yields on their crops. The hope for increased profits was dashed by falling commodity prices. Agri-business profitability is marginal despite favorable growing conditions. In 2016, the Agri-Business community anticipates the operating conditions will remain challenging without a meaningful increase in commodity prices. Weak commodity prices have resulted in a stabilization of the price of agricultural land. However, the current price of land used in agricultural production remains near historical highs.

The tables below are a summary of selected information from the 2010 U.S. Census related to the Company's current market areas. Future growth projections were obtained from the 2011 Kentucky State Data Center at the University of Louisville. At December 31, 2015, Kentucky's unemployment rate was 5.3%. Unemployment data by market was obtained from the Federal Reserve Bank of St. Louis:

	Median Values					
	Unemployment Rate at Dec-15	2010 Household Income	Median Owner occupied Housing units	2010 Census	2020 Estimated	2030 Estimated
Calloway	4.9%	\$ 39,194	\$ 105,300	37,191	40,411	43,618
Christian	6.1%	\$ 37,061	\$ 95,500	73,955	77,840	81,015
Marshall	6.2%	\$ 43,326	\$ 96,900	31,448	33,023	33,787
Todd	5.0%	\$ 36,989	\$ 79,700	12,460	12,958	13,292
Trigg	6.5%	\$ 41,825	\$ 98,300	14,339	16,244	17,913
Fulton	7.2%	\$ 31,965	\$ 55,300	6,813	6,223	5,535
Total population				176,206	186,699	195,160
Estimated ten year population growth				8,542	10,493	8,461
Estimated population growth rate				5.1%	6.0%	4.5%



**Clarksville, Montgomery County, Tennessee ( Clarksville )**

The Clarksville market is the largest market in which the Company has a significant presence. The Clarksville economy has several large employers and economic drivers including the United States Army's 101st Airborne Division with approximately 27,000 active duty military personnel assigned to the division. The many services available on the army installation and the community's modest cost of living have resulted in a sizable military retirement population in the area. Clarksville is also home to Austin Peay State University, a 10,000 student public university as well as a diverse manufacturing sector. The unemployment rate for Montgomery County Tennessee in December 2015 was 5.5%.

In October of 2013, Hankook Tires announced that it will build its first U.S. manufacturing facility in Clarksville. Hankook, a South Korean tire company, will invest approximately \$800 million in a new facility with construction is expected to be completed in 2016. Hankook anticipates that tire production will begin in 2016 and will result in approximately 1,800 full time jobs for the local economy. Hankook chose Clarksville due to its ideal location, strong transportation network and its proximity to automotive assembly plants owned by Nissan, Volkswagen, Toyota and General Motors.

The Clarksville market exhibits stronger growth and income demographics as compared to the communities in Western Kentucky. The 2010 census noted that Clarksville had a median household income of \$48,930 and a \$129,400 median value of owner occupied housing units. Clarksville's demographics are aided by its proximity to the Fort Campbell Army base, its proximity to Nashville, Tennessee, and the absence of a state income tax.

	2010 Census	2020 Estimated	2030 Estimated	2040 Estimated
Clarksville MSA	172,331	221,620	264,680	311,239
Ten year growth rate	27.9%	28.6%	19.4%	17.6%

Source: Center for Business and Economic Research, University of Tennessee, Knoxville

**Middle Tennessee and Nashville MSA**

Cheatham County ( Cheatham ) and Houston County ( Houston ) are located in Middle Tennessee. Both communities are rural and residents of both communities typically rely on employment opportunities in neighboring communities as neither county has a sizeable base of manufacturing jobs. However, Cheatham is located within the Nashville Metropolitan Statistical Area ( Nashville MSA ) and its three largest communities are a 30 minute drive to downtown Nashville. Cheatham's proximity and easy commute to Nashville has resulted in higher levels of income and population growth as compared to Houston. In December of 2015, the unemployment rates in Cheatham and Houston were 4.3% and 7.9%, respectively. The unemployment rates in the state of Tennessee and the Nashville MSA are 5.6% and 4.2%, respectively.

As supported by the tables below, the Company views Clarksville and the Nashville MSA as communities with the most potential for growth. The Company has established one loan production office in the Nashville MSA in October of 2014 and will seek to further expand in lending expertise in our Tennessee markets. The Company's deposit base will allow us to seek loan growth without seeking immediate funding for the growth. The Nashville MSA has a population of approximately 1.6 million (includes Cheatham County, Tennessee listed above) and attractive demographics outlined below:

	2010 Estimated Census Population	Population Change 2000-2010	Median Household Income	Median Value Owner occupied housing units
Nashville TN MSA				
Robertson (Springfield)	66,283	21.8%	\$ 50,820	\$ 149,100
Sumner (Gallatin)	160,645	23.1%	\$ 54,916	\$ 169,100
Wilson (Lebanon)	113,193	28.4%	\$ 60,678	\$ 187,500
Rutherford (Murfreesboro)	262,604	44.3%	\$ 53,770	\$ 157,100
Williamson (Franklin)	183,182	44.7%	\$ 87,832	\$ 335,800
Maury (Columbia)	80,956	16.5%	\$ 46,278	\$ 137,100
Dickson	49,666	15.1%	\$ 44,554	\$ 128,700
Davidson (Nashville)	626,681	10.0%	\$ 45,668	\$ 164,700
Cheatham	39,105	9.0%	\$ 52,585	\$ 155,900

Source: United State Census 2010

	2010 Census	2020 Estimated	2030 Estimated	2040 Estimated
Nashville MSA	1,582,315	2,001,143	2,355,605	2,715,231
Ten year growth rate		26.5%	17.7%	15.3%

Source: Center for Business and Economic Research, University of Tennessee, Knoxville

In addition to the Clarksville and Nashville MSA markets, management views promising opportunities for growth in the midsize metropolitan markets near the Company's current locations. Highly desirable markets include Bowling Green, Kentucky, Hardin, Kentucky and Louisville, Kentucky. These markets provide desirable demographic and growth opportunities as compared to the Company's current footprint. As evident in the table below, Kentucky growth opportunities may be most attractive in Bowling Green, which is approximately 70 miles

from the Company's corporate headquarters. The tables below include the two largest counties by population in the Kentucky and other communities in Kentucky within a two hour drive of the Company's headquarters:

	Census Population	Change 2000-2010	Household Income	Owner occupied housing units
Kentucky				
Henderson	46,250	3.2%	\$ 40,438	\$ 101,200
Hardin (Elizabethtown)	105,543	12.1%	\$ 47,540	\$ 131,900
Daviess (Owensboro)	96,656	5.6%	\$ 42,821	\$ 106,400
McCracken (Paducah)	65,565	0.1%	\$ 41,630	\$ 107,500
Warren (Bowling Green)	113,792	23.0%	\$ 43,954	\$ 135,400
Fayette (Lexington)	295,803	13.5%	\$ 47,469	\$ 159,200
Jefferson (Louisville)	741,096	6.8%	\$ 45,352	\$ 145,900

### Equity Transactions

On December 12, 2008, the Company received an \$18.4 million investment from the United States Treasury ( Treasury ) in the form of preferred stock. The terms of the investment included a 5% dividend for five years, increasing to 9% thereafter. The investment had no stated maturity but could be paid back in whole or part at any time with regulatory approval. In addition to the dividend, the Treasury received a stock Warrant that allowed the Treasury to immediately purchase 243,816 shares of the Company's Common Stock immediately at a strike price of \$11.32 and had a final maturity of December 12, 2018. The amount and price of the warrant were adjusted to 253,667 shares and a strike price of \$10.88 as a result of a 2% stock dividend declared for shareholders of record at September 30, 2010 and October 3, 2011.

In June and July of 2010, the Company sold a total of 3,583,334 shares of Common Stock at \$9.00 per share (\$8.55 net of expense) in a public offering. The net proceeds of the public offering, \$30.4 million, were used for general corporate purposes and included a \$10.0 million investment to the Bank. The sale of common stock in June 2010 included 112,639 shares of treasury stock.

On December 19, 2012, the Company repurchased all outstanding shares of preferred stock at par from the Treasury. The Company did not issue additional capital to repurchase the preferred stock. On January 16, 2013, the Company repurchased the outstanding Warrant from the Treasury for \$256,257. The repurchased Preferred Stock was retired in 2013.

On March 2, 2015, the Company issued 600,000 shares of treasury stock to the Company's ESOP in a transaction as discussed below.

### Stock Repurchases

On October 31, 2014, the Company announced that it intended to purchase an additional 300,000 shares of common stock and may purchase up to 1.0 million shares for general corporate purchases or employee benefit plans. The repurchase program expired on October 31, 2015. On November 16, 2015, the Company announced a new repurchase program of an additional 300,000 shares of common stock that is set to expire December 31, 2017. At December 31, 2015, the Company may purchase 252,798 shares of treasury stock under the currently active repurchase program. For the year ended December 31, 2015, the Company purchased 907,505 shares of common stock at a weighted average price of \$13.14 per share. At December 31, 2015, the Company holds a total of 1,085,888 shares of the Company's common stock as treasury stock at a weighted average price of \$12.41 per share.



## 2015 HopFed Bancorp, Inc. Employee Stock Ownership Plan

On March 2, 2015, the Company implemented the HopFed Bancorp, Inc. 2015 Employee Stock Ownership Plan (the ESOP ) which covers substantially all employees who are at least 21 years old with at least one year of employment with the Company and Heritage Bank USA, Inc. (the Bank ), the Company's commercial bank subsidiary. Employer contributions to the ESOP replaced matching and profit sharing contributions to the Heritage Bank 401(k) Plan sponsored by the Bank. All employees meeting the required service requirements participate in the ESOP. The ESOP has three individuals who have been selected by the Company to serve as trustees. A directed corporate trustee has also been appointed. The ESOP will be administered by a committee (the Committee ) currently composed of eleven employees approved by the Bank's Board of Directors.

On March 2, 2015, the ESOP entered into a loan agreement with the Company to borrow up to \$13,500,000 to purchase up to 1,000,000 shares common stock ( ESOP Loan ). On the same date, the ESOP purchased an initial block of 600,000 shares from the Company at a cost of \$7,884,000 using the proceeds of the ESOP Loan. In accordance with the ESOP Loan documents, the common stock purchased by the ESOP serves as collateral for the ESOP Loan. The ESOP Loan will be repaid principally from discretionary contributions by the Bank to the ESOP over a period ending no later than December 9, 2026. The interest rate on the ESOP Loan is 3.0%. Shares purchased by the ESOP will be held in a suspense account for allocation among participants as the ESOP Loan is repaid. The ESOP shares are dividend paying. Dividends on unearned ESOP shares will be used to repay the ESOP Loan. The Company incurred an expense totaling \$652,000 to fund the ESOP loan payment. As a result of the loan payment, the Company's ESOP released 53,587 shares of stock to individual employees participating in the plan at December 31, 2015.

## Available Information

The Company's filings with the Securities and Exchange Commission ( SEC ), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments thereto, are available on the Company's website as soon as reasonably practicable after the reports are filed with or furnished to the SEC. Copies can be obtained free of charge in the Investor Relations section of the Company's website at [www.bankwithheritage.com](http://www.bankwithheritage.com).

## Lending Activities

*General.* The total gross loan portfolio totaled \$562.5 million at December 31, 2015, representing 62.3% of total assets at that date. Substantially all loans are originated in the Bank's market area. At December 31, 2015, \$181.4 million, or 32.3% of the loan portfolio, consisted of one-to-four family, residential mortgage loans. Other loans secured by real estate include non-residential real estate loans, which amounted to \$214.4 million, or 38.1% of the loan portfolio at December 31, 2015, and multi-family residential loans, which were \$24.7 million, or 4.4% of the loan portfolio at December 31, 2015. At December 31, 2015, construction loans were \$34.9 million, or 6.2% of the loan portfolio, and total consumer and commercial loans totaled \$107.1 million, or 19.0% of the loan portfolio.

*Analysis of Loan Portfolio.* Set forth below is selected data relating to the composition of the loan portfolio by type of loan at the dates indicated. At December 31, 2015, there were no concentrations of loans exceeding 10% of total loans other than as disclosed below.

	2015		2014		2013		2012		2011	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
<u>Type of Loan:</u>										
Real estate loans:										
One-to-four family residential	\$ 181,414	32.3%	\$ 186,891	34.2%	\$ 192,603	34.9%	\$ 203,754	38.0%	\$ 216,095	38.1%
Multi-family residential	24,725	4.4%	25,991	4.8%	29,736	5.4%	33,056	6.2%	33,739	5.9%
Construction	34,878	6.2%	24,241	4.4%	10,618	1.9%	18,900	3.5%	11,931	2.1%
Non-residential (1)	214,410	38.1%	220,124	40.3%	244,241	44.2%	215,342	40.2%	235,823	41.6%
Total real estate loans	455,427	81.0%	457,247	83.7%	477,198	86.4%	471,052	87.9%	497,588	87.7%
Other loans:										
Secured by deposits	14,134	2.5%	8,136	1.5%	3,048	0.6%	3,768	0.7%	4,016	0.7%
Other consumer loans	6,190	1.1%	6,302	1.2%	8,119	1.4%	10,118	1.9%	11,094	2.0%
Commercial loans	86,743	15.4%	74,154	13.6%	64,041	11.6%	50,549	9.5%	54,673	9.6%
Total other loans	107,067	19.0%	88,592	16.3%	75,208	13.6%	64,435	12.1%	69,783	12.3%
	562,494	100.0%	545,839	100.0%	552,406	100.0%	535,487	100.0%	567,371	100.0%
Deferred loan cost, net	(445)		(286)		(92)		146		251	
Allowance for loan losses	(5,700)		(6,289)		(8,682)		(10,648)		(11,262)	
Total	\$ 556,349		\$ 539,264		\$ 543,632		\$ 524,985		\$ 556,360	

(1) Consists of loans secured by first liens on residential lots and loans secured by first mortgages on commercial real property and land.

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*Loan Maturity Schedule.* The following table sets forth certain information at December 31, 2015, regarding the dollar amount of loans maturing in the portfolio based on their contractual maturity dates. Demand loans, loans having no stated schedule of repayments and loans having no stated maturity, and overdrafts are reported as due in one year or less.

	Due the year ending December 31,			3 through 5 years after December 31,	5 through 10 years after December 31,	10 through 15 years after December 31,	Due 15 years after December 31,	Total
	2016	2017	2018	2016	2016	2016	2016	
(Dollars In Thousands)								
One-to-four family residential	\$ 4,482	1,864	3,951	28,552	43,609	28,360	70,596	181,414
Multi-family residential	3,997		546	4,089	7,507	6,005	2,581	24,725
Construction	9,473	1,551	1,540	20,230	1,261	823		34,878
Non-residential	26,902	5,303	24,187	46,790	54,075	28,741	28,412	214,410
Secured by deposits	12,548	541	491	554				14,134
Other	40,664	5,162	13,796	16,067	14,224	2,933	87	92,933
Total	\$ 98,066	14,421	44,511	116,282	120,676	66,862	101,676	562,494

The following table sets forth at December 31, 2015, the dollar amount of all loans due after December 31, 2016, which had predetermined interest rates and had floating or adjustable interest rates.

	Predetermined Rate (Dollars In Thousands)	Floating or Adjustable Rate
One-to-four family residential	\$ 56,093	\$ 120,839
Multi-family residential	12,845	7,883
Construction	20,916	4,489
Non-residential	98,161	89,347
Other	42,105	11,750
Total	\$ 230,120	\$ 234,308

Scheduled contractual principal repayments of loans do not reflect the actual life of such assets. The average life of loans is substantially less than their contractual terms because of prepayments. In addition, due-on-sale clauses on loans generally give the lender the right to declare a loan immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase when current mortgage loan market rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when current mortgage loan market rates are substantially lower than rates on existing mortgage loans.

In the last ten years, the Company has attempted to diversify its loan portfolio mix to mitigate the risk of lending in a geographically limited area. The Company uses several metrics to measure our relative success in this area. The table below identifies loan balances by type as a percentage of total consolidated risk based capital:

Management measures commercial real estate (CRE) concentrations as discussed in *Concentrations of Commercial Real Estate Lending, Sound Risk Management Practices* issued on December 12, 2006, jointly by the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Federal Reserve) and the Federal Deposit Insurance Corporation (FDIC). In this guidance, the agencies make a significant distinction between owner-occupied CRE and non-owner occupied CRE. The agencies have a heightened level of concern with those loans with risk profiles sensitive to the condition of the CRE market.

CRE loans secured by non-farm, non-residential CRE where the primary source of repayment is the cash flow from the ongoing operations and activities conducted by the owner of the property are generally excluded from the guidance. Using the instructions provided in the FDIC call report, the Bank has calculated that \$149.7 million of our loan portfolio, or 150.7% of the Bank's risk based capital, consists of properties classified as non-owner occupied commercial real estate which includes all loans secured by multi-family properties, all construction and land development loans and certain other commercial real estate loans identified by regulations as non-owner occupied. Included in the definition of commercial real estate are \$34.9 million in construction loans and \$22.5 million in land development loans, representing 35.2% and 22.7% of the Bank's risk based capital, respectively. Both of our concentration categories are within regulatory guidelines and appear reasonable to management at this time. However, the Company continues to experience below average credit performance in our land development portfolio. At December 31, 2015, \$10.6 million, or approximately 47.3%, of the Company's land development loans are classified as substandard. The Company's land portfolio accounts for approximately 4.0% of the Company's total loan portfolio. However, the Company's land loans classified as substandard equal 37.8% of all loans classified as substandard by the Company.





*Originations, Purchases and Sales of Loans.* The Bank generally has authority to originate and purchase loans secured by real estate located throughout the United States. Consistent with its emphasis on being a community-oriented financial institution, the Bank conducts substantially all of its lending activities in its market area. The following table sets forth certain information with respect to loan origination activity for the periods indicated.

	Year Ended December 31,		
	2015	2014	2013
	(Dollars In Thousands)		
<b>Loan originations:</b>			
One-to-four family residential	\$ 67,905	\$ 52,357	\$ 38,783
Multi-family residential	5,971	6,717	11,078
Construction	29,939	31,344	20,238
Non-residential	38,810	46,426	73,048
Other	39,097	69,300	57,462
<b>Total loans originated</b>	<b>181,722</b>	<b>206,144</b>	<b>200,609</b>
<b>Loan reductions:</b>			
Transfer to other real estate owned	869	1,579	1,379
(Increase) decrease in deferred loan origination fees, net of income	(159)	194	238
Increase (decrease) in allowance for loan losses	(589)	(2,393)	(1,966)
Loans sold	44,020	33,096	16,943
Transfer to loan held for sale		6,987	
Loan principal payments	120,496	171,049	165,368
<b>Net increase (decrease) in the loan portfolio</b>	<b>\$ 17,085</b>	<b>(\$ 4,368)</b>	<b>\$ 18,647</b>

Loan originations are derived from a number of sources, including existing customers, referrals by real estate agents, depositors and borrowers and advertising, as well as walk-in customers. Solicitation programs consist of advertisements in local media, in addition to occasional participation in various community organizations and events. Real estate loans are originated by the Bank's loan personnel. All of the loan personnel are salaried and may receive additional compensation on a commission basis based on achieving certain performance goals. Loan applications are accepted at any of the Bank's branches.

*Loan Underwriting Policies.* Lending activities are subject to written, non-discriminatory underwriting standards and to loan origination procedures prescribed by the Board of Directors and its management. Detailed loan applications are obtained to determine the ability of borrowers to repay, and the more significant items on these applications are verified through the use of credit reports, financial statements and confirmations. Loan requests exceeding loan officer limits must be approved by the Chief Credit Officer, Chief Executive Officer, the executive loan committee of the Board of Directors or the entire Board of Directors.

Generally, upon receipt of a loan application from a prospective borrower, a credit report and verifications are ordered to confirm specific information relating to the loan applicant's employment, income and credit standing. If a proposed loan is to be secured by a mortgage on real estate, an appraisal of the real estate is undertaken by an appraiser approved by the Board of Directors and licensed or certified (as necessary) by the Commonwealth of Kentucky or the State of Tennessee. In the case of one-to-four family residential mortgage loans, except when the Bank becomes aware of a particular risk of environmental contamination, the Bank generally does not obtain a formal environmental

report on the real estate at the time a loan is made. A formal environmental report may be required in connection with nonresidential real estate loans.

It is the Bank's policy to record a lien on the real estate securing a loan and to obtain a title opinion from Kentucky counsel who provides that the property is free of prior encumbrances and other possible title defects. Title Insurance is generally required on all real estate loans with balances exceeding \$100,000 and all one-to-four family loans that are to be sold in the secondary market.

Borrowers must also obtain hazard insurance policies prior to closing and, when the property is in a flood hazard area, pay flood insurance policy premiums. The majority of real estate loan applications are underwritten and closed in accordance with the Bank's own lending guidelines, which generally do not conform to secondary market guidelines. Although such loans may not be readily saleable in the secondary market, management believes that, if necessary, such loans may be sold to private investors at a discount to par.

The Bank offers a residential fixed rate loan program with maturities of 15, 20, and 30 years. These loans are underwritten and closed in accordance with secondary market standards. These loans are originated with the intent to sell on the secondary market. The Bank offers both servicing retained and servicing released products in an attempt to meet the needs of our customers. At December 31, 2015, the Bank's 1-4 family loan servicing portfolio was approximately \$22.8 million.

The Bank is permitted to lend up to 100% of the appraised value of the residential real property securing a mortgage loan. Under its lending policies, the Bank will originate a one-to-four family residential mortgage loan for owner-occupied property with a loan-to-value ratio of up to 95%. For residential properties that are not owner-occupied, the Bank generally does not lend more than 80% of the appraised value. For all residential mortgage loans, the Bank may increase its lending level on a case-by-case basis, provided that the excess amount is insured with private mortgage insurance. At December 31, 2015, the Bank held approximately \$2.9 million of 1-4 family residential mortgages with a loan to value ratio exceeding 90% without private mortgage insurance. For these loans at December 31, 2015, a total of \$379,000 of these loans are in non-accrual status and none of these loans were past due more than 30 days but less than 89 days.

Under applicable law, with certain limited exceptions, loans and extensions of credit outstanding by a commercial bank to a person at one time shall not exceed 15% of the institution's unimpaired capital and surplus. Loans and extensions of credit fully secured by readily marketable collateral may comprise an additional 10% of unimpaired capital and surplus. Under these limits, the Bank's loans to one borrower were limited to approximately \$16.4 million at December 31, 2015. At that date, the Bank had no lending relationships in excess of the loans-to-one-borrower limit.

Interest rates charged by the Bank on loans are affected principally by competitive factors, the demand for such loans and the supply of funds available for lending purposes. These factors are, in turn, affected by general economic conditions, monetary policies of the federal government, including the Federal Reserve Board, legislative tax policies and government budgetary matters.

*One-to-four Family Residential Lending.* The Bank historically has been and continues to be an originator of one-to-four family residential real estate loans in its market area. At December 31, 2015, one-to-four family residential mortgage loans totaled approximately \$181.4 million, or 32.3% of the Bank's loan portfolio. The Bank originated approximately \$42.6 million in loans that were sold in the secondary market with servicing released. At December 31, 2015, the Bank had approximately \$2.3 million in one-to-four family residential real estate loans past due more than ninety days or in non-accrual status. At December 31, 2015, the Company's allowance for loan loss included \$1.2 million for one to four family residential lending.

The Bank primarily originates residential mortgage loans with adjustable rates. As of December 31, 2015, 69.1% of one-to-four family mortgage loans in the Bank's loan portfolio carried adjustable rates or mature within one year. The Bank's one to four family loan portfolio consists of closed end first and second mortgages as well as opened ended home equity lines of credit. At December 31, 2015, approximately \$147.8 million of the Bank's residential mortgage portfolio consisted of closed end first and junior liens. Such loans are originated for 15, 20 and 30 year terms, in each case amortized on a monthly basis with principal and interest due each month. The interest rates on these mortgages are adjusted once per year, with a maximum adjustment of 1% per adjustment period and a maximum aggregate adjustment of 5% over the life of the loan. Prior to August 1, 1997, rate adjustments on the Bank's adjustable rate loans were indexed to a rate which adjusted annually based upon changes in an index based on the National Monthly Median Cost of Funds, plus a margin of 2.75%. Because the National Monthly Median Cost of Funds is a lagging index, which results in rates changing at a slower pace than rates generally in the marketplace, the Bank changed to a one-year Treasury bill constant maturity ( One Year CMT ), which the Bank believes reflects more current market information and thus allows the Bank to react more quickly to changes in the interest rate environment. In 2004, the Bank increased its margin on its adjustable rate loans to 3.00%. However, the vast majority of the current adjustable rate portfolio maintains a margin of 2.75% over the One Year CMT.

The Bank also originates, to a limited extent, fixed-rate loans for terms of 10 and 15 years. Such loans are secured by first mortgages on one-to-four family, owner-occupied residential real property located in the Bank's market area. Because of the Bank's policy to mitigate its exposure to interest rate risk through the use of adjustable rate rather than fixed rate products, the Bank does not emphasize fixed-rate mortgage loans. Fixed rate mortgage loans originated by the Bank are loans that often do not qualify for the secondary market due to numerous factors not related to credit quality. Typically, these products are not priced to be competitive with secondary market loans but to offer as an alternative if that option is not available. At December 31, 2015, \$56.1 million of the Bank's loan portfolio consisted of fixed-rate one-to-four family first mortgage loans that will mature after December 31, 2016.

At December 31, 2015, the Bank had \$33.6 million in home equity lines of credit outstanding and \$30.0 million of additional credit available. Typically, these loans are for a term of fifteen years and have loan to value ratio of 80% to 100%. The home equity portfolio is priced at a spread to prime, adjusted daily, depending on the customer's loan to value ratio at the time of origination. Many of the home equity lines of credit require monthly interest payments with all unpaid interest and principal due at maturity.

The retention of adjustable rate loans in the Bank's portfolio helps reduce, but does not eliminate, the Bank's exposure to increases in prevailing market interest rates. However, there are unquantifiable credit risks resulting from potential increases in costs to borrowers in the event of upward re-pricing of adjustable-rate loans. It is possible that during periods of rising interest rates, the risk of default on adjustable rate loans may increase due to increases in interest costs to borrowers. Further, although adjustable rate loans allow the Bank to increase the sensitivity of its interest-earning assets to changes in interest rates, the extent of this interest sensitivity is limited by the initial fixed-rate period before the first adjustment and the lifetime interest rate adjustment limitations. This risk is heightened by the Bank's prior practice of offering its adjustable rate mortgages with a 2.0% limitation on annual interest rate adjustments. Accordingly, there can be no assurance that yields on the Bank's adjustable rate loans will fully adjust to compensate for increases in the Bank's cost of funds.

Finally, adjustable rate loans increase the Bank's exposure to decreases in prevailing market interest rates, although the 2.0% limitation on annual decreases in the loans' interest rate tends to offset this effect. In times of declining interest rates, borrowers often refinance into fixed rate loan products, limiting the Bank's ability to significantly increase its interest rate margin on adjustable rate loans in a declining interest rate market. In times of increasing interest rates, the 2.0% annual cap on increases in the interest rates tends to reduce refinancing activity and reduce the Bank's net interest margin.

Neither the fixed rate nor the adjustable rate residential mortgage loans held in the Bank's portfolio are originated in conformity with secondary market guidelines issued by FHLMC or FNMA. As a result, such loans may not be readily saleable in the secondary market to institutional purchasers. However, such loans may still be sold to private investors whose investment strategies do not depend upon loans that satisfy FHLMC or FNMA criteria. Further, given its high liquidity, the Bank does not currently view loan sales as a necessary funding source.

*Construction Lending.* The Bank engages in construction lending involving loans to individuals for construction of one-to-four family residential housing, multi-family housing and non-residential real estate located within the Bank's market area, with such loans converting to permanent financing upon completion of construction. The Bank mitigates its risk with construction loans by imposing a maximum loan-to-value ratio of 80% for homes that will be owner-occupied or being built on a speculative basis.

The Bank also makes loans to qualified builders for the construction of one-to-four family residential housing located in established subdivisions in the Bank's market area. Because such homes are intended for resale, such loans are generally not converted to permanent financing at the Bank. All construction loans are secured by a first lien on the property under construction.

Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. Construction/permanent loans may have adjustable or fixed interest rates and are underwritten in accordance with the same terms and requirements as the Bank's permanent mortgages.

Such loans generally provide for disbursement in stages during a construction period of up to eighteen months, during which period the borrower is required to make payments of interest only. The permanent loans are typically 30-year adjustable rate loans, with the same terms and conditions otherwise offered by the Bank. Monthly payments of principal and interest commence the month following the date the loan is converted to permanent financing. Borrowers must satisfy all credit requirements that would apply to the Bank's permanent mortgage loan financing prior to receiving construction financing for the subject property.

Construction financing generally is considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value at completion of construction or development and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be confronted at or prior to the maturity of the loan, with a project having a value which is insufficient to assure full repayment. The ability of a developer to sell developed lots or completed dwelling units will depend on, among other things, demand, pricing, availability of comparable properties and economic conditions. The Bank has sought to minimize this risk by limiting construction lending to qualified borrowers in the Bank's market area, by requiring the involvement of qualified builders, and by limiting the aggregate amount of outstanding construction loans. At December 31, 2008, the Bank's construction loan portfolio was \$62.3 million. By that time, the Bank had begun to reduce its construction loan exposure due to concerns about a slowing economy. The significant reduction in construction loans has had a negative impact on the Bank's loan portfolio balances and net interest margin. However, the negative impact has been offset by the relatively minor credit problems that have occurred in this portfolio.

At December 31, 2015, the Bank's loan portfolio included \$34.9 million of loans secured by properties under construction, including construction/permanent loans structured to become permanent loans upon the completion of construction and interim construction loans structured to be repaid in full upon completion of construction and receipt of permanent financing. At December 31, 2015, approximately \$5.9 million of construction loans were for one to four family dwellings, approximately \$7.0 million of construction loans were for multi-family dwellings and \$22.0 million were for non-residential real estate. At December 31, 2015, there were no construction loans past due more than ninety days or in non-accrual status. At December 31, 2015, the Company's allowance for loan loss included \$377,000 in the reserve for construction loans.

*Multi-Family Residential and Non-Residential Real Estate Lending.* The Bank's multi-family residential loan portfolio consists of fixed and adjustable rate loans secured by real estate. At December 31, 2015, the Bank had \$24.7 million of multi-family residential loans, which amounted to 4.4% of the Bank's loan portfolio at such date. The Bank's non-residential real estate portfolio generally consists of adjustable and fixed rate loans secured by first mortgages on commercial real estate, farmland, residential lots, and rental property. In most cases, such property is located in the Bank's market area. At December 31, 2015, the Bank had approximately \$214.3 million of such loans, which comprised 38.1% of its loan portfolio.

At December 31, 2015, non-residential real estate loans consisted of \$42.2 million in farmland, \$67.4 million in non-owner occupied properties, and \$82.3 million in owner occupied commercial real estate and \$22.4 million in raw land. The Company currently has no land under development and all lots are completed and available for sale. At December 31, 2015, approximately \$10.6 million, or 47.3% of the Company's land portfolio is classified as substandard, \$329,000, or 0.8% of the Company's farmland portfolio is classified as substandard and \$8.4 million, or 5.6% of the Company's commercial real estate portfolio, is classified as substandard. Together, these three categories represent 70.8% of all substandard loans. The reduction of loans classified as substandard remains a high priority for management.

At December 31, 2015, the Company has no land loans under development. At December 31, 2015, the inventory of land loans includes 84 lots available for sale, respectively with an aggregate loan balance of \$2.7 million, respectively. The average lot has a loan balance of approximately \$32,700. At December 31, 2015, the Company has one land loan, totaling \$1.6, in non-accrual status. The loan has 33 unsold lots that are a mixture of commercial and residential with an average balance per lot of approximately \$47,000 per lot. Also at December 31, 2015, the Company has \$15.5 million land loans on property that is designated for future development in which no meaningful infrastructure has been financed. These loans represent 1,234 acres of land with an average price per acre of approximately \$12,200.

At December 31, 2014, the inventory of land loans included 131 lots available for sale with an aggregate loan balance of \$3.4 million. The average lot had an average loan balance of approximately \$26,300. Also at December 31, 2014, the Company had \$16.8 million in land loans on property that is designated for future development in which no meaningful infrastructure has been financed. These loans represent approximately 1,247 acres of land with an average price per acre of approximately \$13,500. The remaining \$6.5 million in land loans are considered to be used for personal and recreational purposes. At December 31, 2014, the Company had \$18.5 million in land loans on property that is designated for future development in which no meaningful infrastructure has been started. These loans represented approximately 1,322 acres of land with an average price per acre of approximately \$14,000. The reduction of land loans classified as substandard remains a high priority of management.

Multi-family residential real estate loans are underwritten with loan-to-value ratios up to 80% of the appraised value of the property. Non-residential real estate loans are underwritten with loan-to-value ratios up to 65% of the appraised value for raw land and 75% for land development loans. Non-residential real estate loans for agricultural and other non-residential real estate properties are underwritten with loan-to-value ratios up to 85%.

Multi-family residential and non-residential real estate lending entails significant additional risks as compared with one-to-four family residential property lending. Multi-family residential and commercial real estate loans typically involve larger loan balances to single borrowers or groups of related borrowers. The payment experience on such loans typically is dependent on the successful operation of the real estate project, retail establishment or business. These risks can be significantly impacted by supply and demand conditions in the market for the office, retail and residential space, and, as such, may be subject to a greater extent to adverse conditions in the economy generally.



To minimize these risks, the Bank generally limits itself to its market area or to borrowers with which it has prior experience or who are otherwise known to the Bank. It has been the Bank's policy to obtain annual financial statements of the business of the borrower or the project for which multi-family residential real estate or non-residential real estate loans are made. At December 31, 2015, \$2.0 million of multi-family loans were past due more than 90 days or classified as non-accrual. At December 31, 2015, there were \$247,000 in non-residential real estate that were past due by 90 days or more or classified as non-accrual and \$1.6 million in loans secured by raw land that were past due by 90 days or more or classified as non-accrual. Also at December 31, 2015, \$166,000 of loans secured by farmland were past due more than 90 days or classified as non-accrual. At December 31, 2015, the Company's allowance for loan loss included \$227,000 in the reserve for multi-family loans, \$1.4 million in the reserve for loans secured by raw land and \$1.1 million in reserve for non-residential real estate loans.

*Consumer Lending.* The consumer loans currently in the Bank's loan portfolio consist of loans secured by savings deposits and other consumer loans. Savings deposit loans are usually made for up to 100% of the depositor's savings account balance. The interest rate is approximately 2.0% above the rate paid on such deposit account serving as collateral, and the account must be pledged as collateral to secure the loan. Interest generally is billed on a quarterly basis. At December 31, 2015, loans on deposit accounts totaled \$14.1 million, or 2.5% of the Bank's loan portfolio. Other consumer loans include automobile loans, the amount and terms of which are determined by management, and closed end home equity and home improvement loans, which are made for up to 100% of the value of the property. At December 31, 2015, all other consumer loans accounts totaled \$6.2 million, or 1.1% of total loans.

Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and therefore are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At December 31, 2015, \$8,000 in consumer loans are delinquent 90 days or more or classified as non-accrual. At December 31, 2015, the Company's allowance for loan loss included \$358,000 for consumer loans.

In 2013, the Company instituted a centralized lending function for all residential real estate and consumer loans. The centralized process allows for a more standardized and consistent credit decision, a more efficient use of Company resources and provides for the concentration of the Company's compliance and documentation expertise. In 2015, the centralized documentation process was expanded to include all loan originations.

*Commercial Lending.* The Bank originates commercial loans on a secured and, to a lesser extent, unsecured basis. At December 31, 2015, the Bank's commercial loans amounted to \$86.7 million, or 15.4% of the Bank's loan portfolio. The Bank's commercial loans generally are secured by business assets. In addition, the Bank generally obtains guarantees from the principals of the borrower with respect to all commercial loans. At December 31, 2015, there was \$1.2 million in commercial loans delinquent 90 days or more or classified as non-accrual. At December 31, 2015, the Company's allowance for loan loss included \$623,000 in reserve for commercial loans.

In 2015, the Company experienced an increase in net charge offs as compared to 2014. In 2015, the Company's net charge offs were \$1.6 million, with \$911,000 in charges offs related to one development loan relationship. In 2014, the Company's net charge offs were \$120,000, which included a \$1.1 million in recoveries of previously charged off loans. In 2013, net charge offs were \$3.6 million.

At December 31, 2015, the Company's level of classified loans to risk based capital is 28.4%. The Company seeks to maintain a level of classified assets at or below 30% of risk based capital. We will continue to focus our efforts to reduce the level of classified assets on our land portfolio, in which a small number of land development loans account

for 39.2% of the total dollar amount of the Company's classified assets.

## Non-accrual Loans and Other Problem Assets

The Bank's non-accrual loans totaled 1.32% of total loans at December 31, 2015. Loans are placed on a non-accrual status when the loan is past due in excess of 90 days or the collection of principal and interest is doubtful. The Bank places a high priority on contacting customers by telephone as a primary method of determining the status of delinquent loans and the action necessary to resolve any payment problem. The Bank's management performs quality reviews of problem assets to determine the necessity of establishing additional loss reserves. The Bank's total non-performing assets to total asset ratio was 1.01% at December 31, 2015.

The following table sets forth information with respect to the Bank's non-accrual loans at the dates indicated.

	2015	2014	At December 31,		
			2013	2012	2011
	(Dollars In Thousands)				
Accruing loans which are contractually past due 90 days or more:					
Residential real estate	\$	\$	\$	\$	\$
Non-residential real estate					
Consumer					
Commercial					
Total					
Non-Accrual Loans:					
Construction			175		
Multi-family	1,968	95		38	
Residential real estate	2,282	1,501	948	2,313	2,309
Land	1,553	215	1,218	2,768	1,330
Non-residential real estate	247	1,159	6,546	1,134	2,231
Farmland	166	115	703	648	
Consumer	8		13	145	9
Commercial	1,198	90	463	617	254
Total non-accrual loans	\$ 7,422	\$ 3,175	\$ 10,066	\$ 7,663	\$ 6,133
Percentage of total loans	1.32%	0.58%	1.82%	1.43%	1.08%

Federal regulations require commercial banks to classify their assets on the basis of quality on a regular basis. In determining the classification of an asset, the Company utilizes a Classified Asset Committee consisting of members of senior management, accounting, credit analysis, loan administration, loan review, internal audit and collections. The committee is charged with determining the value of assets that are potentially impaired as well as the accurate reporting of Troubled Debt Restructuring (TDR) assets as defined later in this report. The committee's function is an important step in management's determination as to the necessary level of funding required in the Company's allowance for loan loss account.

An asset meeting one of the classification definitions set forth below may be classified and still be a performing loan. An asset is classified as substandard if it is determined to be inadequately protected by the current retained earnings and paying capacity of the obligor or of the collateral pledged, if any.



An asset is classified as doubtful if full collection is highly questionable or improbable. An asset is classified as loss if it is considered uncollectible, even if a partial recovery could be expected in the future. The regulations also provide for a special mention designation, described as assets which do not currently expose a savings institution to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving management's close attention. Such assets designated as special mention may include non-performing loans consistent with the above definition.

Assets classified as substandard or doubtful require a savings institution to conduct an impairment test to determine if the establishment of a specific reserve against the allowance for loan loss account is necessary. Typically, the basis for a loan impairment test is the current market value of the collateral, discounted to allow for selling and carrying cost. Typically, new appraisals on 1-4 family properties are discounted 10% to 15% from the appraised value while land and commercial real estate are discounted at 15% to 25% of new appraised values depending on the perceived marketability of the property.

The Company requires a new appraisal for all impairment testing of collateral when the loan balance exceeds \$250,000. For loans less than \$250,000, the Company may choose to use an old appraisal and provide additional discounts to the appraised value in determining the amount of specific reserve required. In the last twelve months, the Company has found that appraisers face an increase in request for services and the time between a request for an appraisal and its completion is longer than normal, up to sixty days for complex multi-family or commercial properties. During the interim, the Company may use an old appraisal with larger discounts to ascertain the likelihood of a loan impairment until a current appraisal is received.

If an asset or portion thereof is classified loss, we establish a specific reserve for such amount. If the Company determines that a loan relationship is collateral dependent, it will charge off the portion of that loan that is deemed to be impaired. The Company defines collateral dependent as any loan in that the customer will be unable to reduce the principal balance of the loan without the complete or partial sale of the collateral.

State and federal examiners may disagree with management's classifications. If management does not agree with an examiner's classification of an asset, it may appeal this determination to the appropriate supervisory examiner with the KDFI and FDIC. Management regularly reviews its assets to determine whether any assets require classification or re-classification. At December 31, 2015, the Bank had \$28.1 million in loans classified as substandard. Loans classified as substandard or doubtful by the Bank meet our classification of impaired loans, as defined by ASC 942-310-45-1. At December 31, 2015, and including our most recent examination, there were no material disagreements between examiners, auditors and management regarding risk grading or the funding of the allowance for loan loss account.

The tables below provide a summary of loans classified by the Bank as special mention, substandard and doubtful by category for the years ended December 31, 2015, and December 31, 2014. The table also identifies the amount of the Bank's allowance for loan loss account specifically allocated to individual loans for the specific periods below:

	Special		Specific Allowance for
December 31, 2015	Mention	Substandard	Doubtful Impairment
One-to-four family residential	\$ 41	3,229	60
Home equity line of credit		169	
Junior lien	35	16	
Multi-family		3,081	138
Construction			
Land	41	10,618	69
Non-residential real estate	2,489	8,357	134
Farmland		329	
Consumer		201	49
Commercial	352	2,074	180
Total	\$ 2,958	28,074	630

	Special		Specific Allowance for
December 31, 2014	Mention	Substandard	Doubtful Impairment
One-to-four family residential	\$ 203	4,219	51
Home equity line of credit		757	
Junior lien	40	37	
Multi-family	2,904	3,021	
Construction			
Land	362	10,964	663
Non-residential real estate	5,492	13,250	738
Farmland	516	2,237	
Consumer	21	299	62
Commercial	325	2,583	
Total	\$ 9,863	37,367	1,514

### Troubled Debt Restructuring

Due to challenges in the local and national economy that continue to persist, the Company has had more of its customers incur financial problems. These customers may request temporary or permanent modification of loans in an effort to avoid foreclosure. The Company analyzes each request separately and grants loan modifications based on the customer's ability to eventually repay the loan and return to the original loan terms, the customer's current loan status and the current and projected future value of the Bank's collateral. Loans that are modified as a result of a customer's financial distress are classified as Troubled Debt Restructuring (TDR). The classification of a loan as TDR is important in that it indicates that a particular customer may not be past due but represents a credit weakness due to the Bank's willingness to modify loan terms based on the financial weakness of the borrower.



The classification of a loan as a TDR may represent the Company's last best chance to work with a distressed customer before foreclosure proceedings begin. At December 31, 2013, the Company had no loans classified as TDR. At December 31, 2015, the Company had \$5.5 million in non-residential real estate loans classified as TDR, with all such loans reported as TDR's performing as agreed by the loans modified terms. At December 31, 2014, the Company had \$3.3 million in non-residential real estate loans classified as performing TDRs. Loan classified as TDR in both 2015 and 2014 were done so due to the borrower's declining cash flow and the Company's concession to temporarily allow interest only payments on balances outstanding. Of the loans classified as TDR at December 31, 2015, \$2.3 million are currently making interest only payments. The remaining \$3.2 million in TDR balances at December 31, 2015, are currently paying principal and interest payments. A summary of loans classified as TDR and the respective TDR activity for the year ended December 31, 2015, can be found in the table below:

	Balance at December 31, 2014	New TDR	Loss on Foreclosure	Loan Amortization	Balance at December 31, 2015
(Dollars in Thousands)					
Non-residential real estate	\$ 3,284	2,265		(13)	5,536
Total TDR	\$ 3,284	2,265		(13)	5,536

A summary of loans classified as TDR and the respective TDR activity for the year ended December 31, 2014, can be found in the table below:

	Balance at December 31, 2013	New TDR	Loss on Foreclosure	Transfer to Held for Sale	Balance at December 31, 2014
(Dollars in Thousands)					
Non-residential real estate		10,271		(6,987)	3,284
Total TDR		10,271		(6,987)	3,284

Real estate acquired by the Bank as a result of foreclosure is classified as real estate owned until such time as it is sold. The Bank generally tries to sell the property at its current market price. The current market price is determined by obtaining an appraisal prior to the acquisition of the property. When such property is acquired, it is recorded at its fair value less estimated costs of sale. In the last eighteen months, the Company has determined that properties acquired through foreclosure have experienced a significant loss in market value as compared to the market value at the time of the origination of the loan. At the time of foreclosure, the collateral is reduced in value to its fair market value less holding and selling expenses and the remaining balance is charged against the allowance for loan losses.

Subsequent to foreclosure, in accordance with accounting principles generally accepted in the United States of America, a valuation allowance is established if the carrying value of the property exceeds its fair value net of related selling expenses. The value of other real estate owned is periodically evaluated, no less than annually, to ascertain its current market value. Additional reductions in market value are recognized as an expense through a charge to losses on real estate owned. At December 31, 2015, the Bank's real estate and other assets owned totaled \$1.7 million.



The following table sets forth information with respect to the Bank's real estate and other assets owned at December 31, 2015, December 31, 2014, and December 31, 2013:

	2015	2014	2013
	(Dollars in Thousands)		
One-to-four family first mortgages	\$ 55	159	350
Land	943	1,768	1,124
Non-residential real estate	738		200
Total real estate and other assets owned	\$ 1,736	1,927	1,674

*Allowance for Loan Losses.* In originating loans, the Bank recognizes that credit losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the security for the loan. It is management's policy to maintain an adequate allowance for loan losses based on, among other things, the Bank's and the industry's historical loan loss experience, evaluation of economic conditions, regular reviews of delinquencies and loan portfolio quality and evolving standards imposed by federal bank examiners and other regulatory agencies. The Bank increases its allowance for loan losses by charging provisions for loan losses against the Bank's income.

Management will continue to actively monitor the Bank's asset quality and allowance for loan losses. Management will charge off loans and properties acquired in settlement of loans against the allowances for loan losses on such loans and such properties when appropriate and will provide specific loss allowances when necessary. Although management believes it uses the best information available to make determinations with respect to the allowances for loan losses and believes such allowances are adequate, future adjustments may be necessary if economic conditions differ substantially from the economic conditions in the assumptions used in making the initial determinations.

The Bank's methodology for establishing the allowance for loan losses takes into consideration probable losses that have been identified in connection with specific assets as well as losses that have not been identified but can be expected to occur. Management conducts regular reviews of the Bank's assets and evaluates the need to establish allowances on the basis of this review. Allowances are established by the Board of Directors on a quarterly basis based on an assessment of risk in the Bank's assets taking into consideration the composition and quality of the portfolio, delinquency trends, current charge-off and loss experience, loan concentrations, the state of the real estate market, regulatory reviews conducted in the regulatory examination process and economic conditions generally.

Specific reserves will be provided for individual assets, or portions of assets, when ultimate collection is considered improbable by management based on the current payment status of the assets and the fair value of the security. At the date of foreclosure or other repossession, the Bank would transfer the property to real estate acquired in settlement of loans initially at the lower of cost or estimated fair value and subsequently at the lower of book value or fair value less estimated selling costs. Any portion of the outstanding loan balance in excess of fair value less estimated selling costs would be charged off against the allowance for loan losses. If, upon ultimate disposition of the property, net sales proceeds exceed the net carrying value of the property, a gain on sale of other real estate would be recorded.

Financial institutions must provide adequate disclosure of the methodology used regarding maintenance of an adequate allowance for loan and lease losses and an effective loan review system. The Bank utilizes a combination of its twelve quarter loan loss history and the sum of all impairment testing completed on individually classified loans deemed collateral dependent.



The charge off history is weighted using the sum of the year's digits. This method provides a 15.4% weight to the most recent quarterly losses, then 14.1% for the prior quarter's losses, 12.8% for the 2<sup>nd</sup> prior quarter's losses and 11.5% for the prior quarter's losses and continuing for twelve quarters. Using this method, the Bank trends for increasing or decreasing levels of charge offs may materially impact the funding level of the allowance for loan loss account. Additionally, the Bank reserves the loss amount of any loans deemed to be impaired. The Bank also applies certain qualitative factors in reviewing its allowance funding, including local and national delinquency and loss trends, noted concentrations or risk and recent additions to regulator guidance. Financial institutions regulated by the KDFI and FDIC may require institutions to immediately charge off any portion of a collateral dependent loan that is deemed to be impaired.

The following table sets forth an analysis of the Bank's allowance for loan losses for the years indicated.

	2015	Year Ended December 31,			
		2014	2013	2012	2011
		(Dollars in thousands)			
Balance at beginning of period	\$ 6,289	8,682	10,648	11,262	9,830
Loans charged off:					
Commercial loans	(1,334)	(501)	(2,802)	(2,727)	(3,596)
Consumer loans and overdrafts	(298)	(415)	(649)	(510)	(371)
Residential real estate	(235)	(316)	(993)	(447)	(908)
Total charge-offs	(1,867)	(1,232)	(4,444)	(3,684)	(4,875)
Recoveries	227	1,112	874	795	386
Net loans charged off	(1,640)	(120)	(3,570)	(2,889)	(4,489)
Provision for loan losses	1,051	(2,273)	1,604	2,275	5,921
Balance at end of period	\$ 5,700	6,289	8,682	10,648	11,262
Ratio of net charge-offs to average loans outstanding during the period	0.29%	0.03%	0.66%	0.52%	0.76%

The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated. Management believes that the allowance can be allocated by category only on an approximate basis. The allocation of the allowance to each category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	2015		2014		2013		2012	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
(Dollars in thousands)								
One-to-four family	\$ 1,239	32.3%	\$ 1,393	34.2%	\$ 2,305	34.9%	\$ 3,094	38.0%
Construction	377	6.2%	146	4.4%	88	1.9%	256	3.5%
Multi-family residential	227	4.4%	85	4.8%	466	5.4%	524	6.2%
Non-residential	2,876	38.1%	3,667	40.3%	4,534	44.2%	5,817	40.2%
Secured by deposits		2.5%		1.5%		0.6%		0.7%
Other loans	981	16.5%	998	14.8%	1,289	13.0%	957	11.4%
Total allowance for loan losses	\$ 5,700	100.0%	\$ 6,289	100.0%	\$ 8,682	100.0%	\$ 10,648	100.0%

	At December 31, 2011	
	Amount	Percent of Loans in Each Category to Total Loans
(Dollars In Thousands)		
One-to-four family	\$ 3,325	38.1%
Construction	139	2.1%
Multi-family residential	1,201	5.9%
Non-residential	5,003	41.6%
Secured by deposits		0.7%
Other consumer loans	1,594	11.6%
Total allowance for loan losses	\$ 11,262	100.0%

## Investment Activities

The Company makes investments in order to maintain the levels of liquid assets required by regulatory authorities and manage cash flow, diversify its assets, obtain yield and to satisfy certain requirements for favorable tax treatment. The principal objective of the investment policy is to earn as high a rate of return as possible, but to consider also financial or credit risk, liquidity risk and interest rate risk. The investment activities of the Corporation and the Bank consist primarily of investments in U.S. Government agency securities, municipal and corporate bonds, CMOs (see definition below), and mortgage-backed securities. Typical investments include federally sponsored agency mortgage

pass-through and federally sponsored agency and mortgage-related securities. Investment and aggregate investment limitations and credit quality parameters of each class of investment are prescribed in the Bank's investment policy. The Corporation and the Bank perform analyses on mortgage-related securities prior to purchase and on an ongoing basis to determine the impact on earnings and market value under various interest rate and prepayment conditions. Securities purchases must be approved by the Bank's Chief Financial Officer or President. The Board of Directors reviews all securities transactions on a monthly basis.

At December 31, 2015, securities with an amortized cost of \$233.4 million and an approximate market value of \$237.2 million were classified as available for sale. Management presently does not intend to sell such securities and, based on the current liquidity level and the access to borrowings through the FHLB of Cincinnati, management currently does not anticipate that the Corporation or the Bank will be placed in a position of having to sell securities with material unrealized losses.

***Mortgage-Backed and Related Securities.*** Mortgage-backed securities represent a participation interest in a pool of one-to-four family or multi-family mortgages, the principal and interest payments on which are passed from the mortgage originators through intermediaries that pool and repackage the participation interest in the form of securities to investors such as the Bank. CMOs are a variation of mortgage-backed securities in which the mortgage pool is divided into specific classes, with different classes receiving different principal reduction streams based on numerous factors, including prepayments speeds. Such intermediaries may include quasi-governmental agencies such as FHLMC, FNMA and the Government National Mortgage Association (GNMA) which guarantees the payment of principal and interest to investors. At December 31, 2015, the Company has \$66.4 million in U.S. Government Agency mortgage-backed securities and \$19.5 million in U.S. Agency CMO securities. At December 31, 2015, this portfolio has approximately \$34.0 million that were originated through GNMA, approximately \$43.8 million that were originated through FNMA, and approximately \$8.1 million that were originated through FHLMC.

Mortgage-backed securities are typically issued with stated principal amounts and the securities are backed by pools of mortgages that have loans with interest rates that are within a range and have similar maturities. The underlying pool of mortgages can be composed of either fixed-rate or adjustable-rate mortgage loans. Mortgage-backed securities generally are referred to as mortgage participation certificates or pass-through certificates. As a result, the interest rate risk characteristics of the underlying pool of mortgages, i.e., fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The life of a mortgage-backed pass-through security is equal to the life of the underlying mortgages. The actual maturity of a mortgage-backed security varies, depending on when the mortgagors prepay or repay the underlying mortgages. Prepayments of the underlying mortgages may shorten the life of the investment, thereby adversely affecting its yield to maturity and the related market value of the mortgage-backed security.

The yield on mortgage backed securities is based upon the interest income and the amortization of the premium or accretion of the discount related to the mortgage-backed security. Premiums and discounts on mortgage-backed securities are amortized or accreted over the estimated term of the securities using a level yield method. The prepayment assumptions used to determine the amortization period for premiums and discounts can significantly affect the yield of the mortgage-backed security, and these assumptions are reviewed periodically to reflect the actual prepayment. The actual prepayments of the underlying mortgages depend on many factors, including the type of mortgage, the coupon rate, the age of the mortgages, the geographical location of the underlying real estate collateralizing the mortgages and general levels of market interest rates. The difference between the interest rates on the underlying mortgages and the prevailing mortgage interest rates is an important determinant in the rate of prepayments. During periods of falling mortgage interest rates, prepayments generally increase, and, conversely, during periods of rising mortgage interest rates, prepayments generally decrease. If the coupon rate of the underlying mortgage significantly exceeds the prevailing market interest rates offered for mortgage loans, refinancing generally increases and accelerates the prepayment of the underlying mortgages. Prepayment experience is more difficult to estimate for adjustable-rate mortgage-backed securities.

The Company owns \$3.7 million in securities collateralized by federally insured student loans. These securities are floating rate and are indexed to one month libor and reset each quarter. The collateral provides approximately 97% guarantee of SLMA and current have a weighted average book value equal to 95.5% of par. Beginning January 1, 2015, Basel III placed new and excessive risk weighting requirements on specific support bonds, of which the Company sold in the first quarter of 2015. The risk weightings on the \$3.7 million in bonds owned by the Company are currently 20%.

The Company currently owns a trust preferred security issued as a private placement by First Financial Services Corporation of Elizabethtown, Kentucky (FFKY). The security has a \$2.0 million par value, a book value of \$1.6 million and a market value of \$1.9 million. On January 1, 2015, FFKY was purchased by Community Bank Shares of Indiana (CBIN). CBIN terminated the interest extension for the securities by transferring funds to the debentures trustees to pay all interest payments due. At December 31, 2015, all interest payments on this security are current.

During 2015, CBIN changed its name to Your Community Bank and changed its NASDAQ ticker symbol to YCB. See note 2 of the Audited Financial Statements for more information concerning this security.

Amortizing U.S. Agency securities owned by the Company are similar in structure to mortgage backed securities. The Company owns two types of amortizing agency securities, both of which are issued with the full faith and credit guarantee of the Small Business Administration (SBA). The Small Business Investment Corporation (SBIC) bonds include pools of SBA loans for business equipment with a ten year maturity. The Small Business Administration Participation Notes (SBAP) has a twenty year maturity and is secured by pools of commercial real estate loans guaranteed by the SBA. Both investments provide superior yields to mortgage backed securities with a credit rating equal to GNMA and superior to FHLMC and FNMA. Historically, the actual cash flows and prepayment speeds for SBIC and SBAP bonds are typically slower than similar maturities for mortgage backed securities due to the cost of refinancing SBA loans. At December 31, 2015, the Company owns \$6.0 million in SBIC notes, \$3.1 million in floating rate SBA pools and \$53.3 million at SBAP notes.

The following table sets forth the carrying value of the investment securities at the dates indicated.

	At December 31,		
	2015	2014	2013
	(In thousands)		
FHLB stock, restricted	\$ 4,428	4,428	4,428
Securities available for sale:			
U.S. Treasury securities	2,000	3,980	
U.S. Agency securities, non-amortizing	30,484	24,172	13,148
U.S. Agency securities, amortizing	62,449	79,080	106,875
Mortgage-backed securities	66,379	82,172	87,803
Agency CMO	19,510	27,995	16,010
Tax free municipal bonds	44,659	61,047	65,459
Taxable municipal bonds	6,177	12,043	18,057
Corporate bonds		2,007	1,984
Non-Agency CMO	3,654	9,643	8,085
Trust preferred security	1,865	1,489	1,489
Total investment securities	\$ 241,605	\$ 308,056	\$ 323,338

The following table sets forth information on the scheduled maturities, amortized cost, market values and average yields for non-amortizing U.S. Government agency securities, corporate bonds and municipal securities in the investment portfolio at December 31, 2015. At such date, \$11.4 million of the non-amortizing agency securities were callable and/or due on or before March 31, 2018, and \$19.1 million were not callable. In addition, approximately \$62.4 million in small business administration amortizing bonds require periodic principal payments. At December 31, 2015, \$35.8 million of tax free municipals and \$1.1 million of taxable all municipal securities were callable between December 2016 and February 2022. The average yield for the tax free municipal security portfolio is quoted as a taxable equivalent yield.

One Year or Less		One to Five Years		Five to Ten Years		After Ten Years		Total Investment Portfolio		
Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Average Yield	Carrying Value	Market Value	Average Yield
(Dollars in thousands)										



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Non-amortizing U.S. agency securities	\$	%	\$ 4,166	1.76%	\$ 22,344	2.12%	\$ 3,974	3.21%	\$ 30,484	\$ 30,484	2.21%
Taxable municipal bonds	\$	%	\$ 3,476	3.17%	\$ 1,933	2.09%	\$ 768	3.19%	\$ 6,177	\$ 6,177	2.84%
Tax free municipal bonds		%	\$ 8,662	4.33%	\$ 18,516	4.76%	\$ 17,481	5.84%	\$ 44,659	\$ 44,659	5.10%
Trust preferred							\$ 1,865	10.94%	\$ 1,865	\$ 1,865	10.9%
U.S. Treasury bonds			\$ 2,000	0.84%		n/a		n/a	\$ 2,000	\$ 2,000	0.84%

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## Deposit Activity and Other Sources of Funds

*General.* Deposits are the primary source of the Bank's funds for lending, investment activities and general operational purposes. In addition to deposits, the Bank derives funds from loan principal and interest repayments, maturities of investment securities and mortgage-backed securities and interest payments thereon. Although scheduled loan repayments are a relatively stable source of funds, deposit inflows and outflows are significantly influenced by general interest rates and money market conditions. Borrowings may be used on a short-term basis to compensate for reductions in the availability of funds, or on a longer term basis for general corporate purposes. The Bank has access to borrow from the FHLB of Cincinnati. The Bank may rely upon retail deposits rather than borrowings as its primary source of funding for future asset growth.

In 2015, 2014 and 2013, weak loan demand and high levels of liquidity have made it difficult to maintain a desirable level of profitability. Therefore, management is placing an emphasis on reducing the Bank's cost of funds ratio. The reduction in cost of funds will be accomplished by changing the deposit mix and overall funding mix of the Bank. First, we continue to place a strong marketing emphasis on non-interest bearing checking accounts. In each of the last four years, we opened more than 4,000 non-interest checking accounts. For the years ended December 31, 2015, 2014, and 2013, the average balance of non-interest checking accounts has increased by \$8.4 million, \$12.5 million and \$8.1 million, respectively. While growing transaction accounts, we have successfully reduced our interest expense for time deposits. This reduction was accomplished by allowing higher costing deposits to re-price to lower levels or leave the Bank. At December 31, 2015, total time deposits were \$314.7 million, a decline of \$17.2 million and \$50.1 million as compared to December 31, 2014, and December 31, 2013, respectively.

*Deposits.* The Bank attracts deposits principally from within its market area by offering competitive rates on its deposit instruments, including money market accounts, passbook savings accounts, individual retirement accounts, and certificates of deposit which range in maturity from three months to five years. Deposit terms vary according to the minimum balance required and the length of time the funds must remain on deposit and the interest rate. Maturities, terms, service fees and withdrawal penalties for its deposit accounts are established by the Bank on a periodic basis. The Bank reviews its deposit mix and pricing on a weekly basis. In determining the characteristics of its deposit accounts, the Bank considers the rates offered by competing institutions, lending and liquidity requirements, growth goals and federal regulations.

The Bank has, on a limited basis, utilized brokered deposits to augment its funding requirements. At December 31, 2015, the Bank had \$34.4 million in brokered deposits as compared to \$37.1 million at December 31, 2014. Given the high level of liquidity maintained by the Bank, it is our current practice to not replace the majority of brokered time deposits once they mature or, where applicable, the Bank tenders a call on the deposit. All brokered deposits are FDIC insured.

The Bank attempts to compete for deposits with other institutions in its market area by offering competitively priced deposit instruments that are tailored to the needs of its customers. Additionally, the Bank seeks to meet customers needs by providing convenient customer service to the community. With the exception of brokered deposits, substantially all of the Bank's depositors are Kentucky or Tennessee residents who reside in the Bank's market area.

Deposits in the Bank at December 31, 2015, were represented by the various types of deposit programs described below.

Interest Rate*	Minimum Term	Category	Minimum Amount	Balance	Percentage of Total Deposits
(In thousands)					
%	None	Non-interest bearing	\$ 100	\$ 125,070	16.9%
0.05%*	None	Interest checking accounts	1,500	203,779	27.6%
0.10%	None	Savings and money market	10	95,893	13.0%
				424,742	57.5%
Certificates of Deposit					
0.12%	3 months or less	Fixed-term, fixed rate	1,000	100,759	13.6%
0.22%	3 to 12 months	Fixed-term, fixed-rate	1,000	100,570	13.6%
0.44%	12 to 24-months	Fixed-term, fixed-rate	1,000	60,281	8.1%
0.97%	24 to 36-months	Fixed-term, fixed-rate	1,000	36,975	5.0%
0.85%	36 to 48-months	Fixed-term, fixed-rate	1,000	6,441	0.9%
1.10%	48 to 60-months	Fixed-term, fixed rate	1,000	9,638	1.3%
				314,664	42.5%
				\$ 739,406	100. 0%

\* Represents current interest rate offered by the Bank.

The following table sets forth, for the periods indicated, the average balances and interest rates based on month-end balances for interest-bearing demand deposits and time deposits.

	Year Ended December 31,					
	2015		2014		2013	
	Interest-bearing demand deposits	Time deposits	Interest-bearing demand deposits	Time deposits	Interest-bearing demand deposits	Time deposits
(Dollars in thousands)						
Average Balance	\$ 291,927	\$ 320,889	\$ 284,607	\$ 356,069	\$ 250,895	\$ 407,000
Average Rate	0.44%	1.16%	0.51%	1.16%	0.56%	1.41%

The following table sets forth the change in dollar amount of deposits in the various types of accounts offered by the Bank between the dates indicated.

	Balance at December 31, 2015	% of Deposits	Increase (Decrease) from December 31, 2014 (Dollars in thousands)	Balance at December 31, 2014	% of Deposits	Increase (Decrease) from December 31, 2013
Non-interest bearing	\$ 125,070	16.9%	\$ 10,019	\$ 115,051	15.7%	\$ 9,799
Interest checking	203,779	27.5%	17,163	186,616	25.5%	2,973
Savings and MMDA	95,893	13.0%	(1,833)	97,726	13.4%	5,620
Time deposits	314,664	42.6%	(17,251)	331,915	45.4%	(50,081)
Total	\$ 739,406	100.0%	\$ 8,098	\$ 731,308	100.0%	\$ (31,689)

	Balance at December 31, 2013	% of Deposits	Increase (Decrease) from December 31, 2012 (Dollars in thousands)	Balance at December 31, 2012	% of Deposits
Non-interest bearing	\$ 105,252	13.8%	\$ 11,169	\$ 94,083	12.4%
Interest checking	183,643	24.1%	36,596	147,047	19.4%
Savings and MMDA.	92,106	12.1%	10,463	81,643	10.7%
Time deposits	381,996	50.0%	(55,096)	437,092	57.5%
Total	762,997	100.0%	\$ 3,132	\$ 759,865	100.0%

The following table sets forth the time deposits in the Bank classified by rates at the dates indicated.

	2015	At December 31, 2014	2013
		(In thousands)	
0.01 - 2.00%	\$ 251,085	\$ 252,416	\$ 292,992
2.01 - 4.00%	63,579	79,408	89,002
4.01 - 6.00%		91	2
Total	\$ 314,664	\$ 331,915	\$ 381,996

The following table sets forth the amount and maturities of time deposits at December 31, 2015.

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	Less Than One Year	1-2 Years	Amount Due 2-3 Years	After 3 Years	Total
			(In thousands)		
0.00 - 2.00%	\$ 138,609	\$ 60,281	36,975	\$ 15,220	\$ 251,085
2.01 - 4.00%	62,720			859	63,579
4.01 - 6.00%					
Total	\$ 201,329	\$ 60,281	\$ 36,975	\$ 16,079	\$ 314,664

The following table indicates the amount of the Bank's certificates of deposit of \$250,000 or more by time remaining until maturity as of December 31, 2015.

Maturity Period	Certificates of Deposit (In thousands)
Three months or less	\$ 20,515
Over three through six months	13,782
Over six through 12 months	22,983
Over 12 months	21,499
Total	\$ 78,779

At December 31, 2015, certificates of deposits included approximately \$163.9 million in deposits greater than \$100,000, as compared to \$169.3 million and \$200.2 million at December 31, 2014, and December 31, 2013, respectively. Certificates of deposit at December 31, 2015, included approximately \$78.8 million of deposits with balances of \$250,000 or more, compared to \$78.8 million and \$100.1 million at December 31, 2014, and December 31, 2013, respectively. Such time deposits may be risky because their continued presence in the Bank is dependent partially upon the rates paid by the Bank rather than any customer relationship and, therefore, may be withdrawn upon maturity if another institution offers higher interest rates. The Bank may be required to resort to other funding sources such as borrowings or sales of its securities available for sale if the Bank believes that increasing its rates to maintain such deposits would adversely affect its operating results. At this time, the Bank does not believe that it will need to significantly increase its deposit rates to maintain such certificates of deposit and, therefore, does not anticipate resorting to alternative funding sources. See Note 6 of Notes to Consolidated Financial Statements.

The following table sets forth the deposit activities of the Bank for the periods indicated.

	Year Ended December 31,		
	2015	2014	2013
	(In thousands)		
Deposits	\$ 144,381	\$ 155,837	\$ 180,643
Withdrawals	(140,277)	(191,863)	(181,235)
Net increase (decrease) before interest credited	4,104	(36,026)	(592)
Interest credited	3,994	4,337	3,724
Net increase (decrease) in deposits	\$ 8,098	(\$ 31,689)	\$ 3,132

**Borrowings.** Savings deposits historically have been the primary source of funds for the Bank's lending, investments and general operating activities. The Bank is authorized, however, to use advances from the FHLB of Cincinnati to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The FHLB of Cincinnati functions as a central reserve bank providing credit for savings institutions and certain other member financial institutions.

As a member of the FHLB System, the Bank is required to own stock in the FHLB of Cincinnati and is authorized to apply for advances. Advances are pursuant to several different programs, each of which has its own interest rate and range of maturities. The Bank has entered into a Cash Management Advance program with FHLB. See Note 7 of

Notes to Consolidated Financial Statements. Advances from the FHLB of Cincinnati were \$15.0 million at December 31, 2015. Also at December 31, 2015, the FHLB has issued letters of credit totaling \$32.5 million for the benefit of municipalities to collateralize deposits. All FHLB advances and letters of credit are secured by a blanket security agreement in which the Bank has pledged its 1-4 family first mortgage loans held in the Bank's loan portfolio.

On September 25, 2003, the Company issued \$10,310,000 in floating rate junior subordinated debentures with a thirty year maturity and callable at the Company's discretion quarterly after September 25, 2008. The subordinated debentures are priced at a variable rate equal to the three month Libor (London Inter Bank Offering Rate) plus 3.10%. The most recent reset date for the interest rate on the subordinated debentures was January 8, 2016. On January 8, 2016, the three-month Libor rate was 0.62%. Therefore, the rate of the security is 3.72%. The securities are immediately callable in the event of a change in tax or accounting law that has a significant negative impact to issuing these securities. Otherwise, the securities are callable on a quarterly basis.

For regulatory purposes, subordinated debentures may be treated as Tier I capital. Federal regulations limit the use of subordinated debentures to 25% of total Tier I capital. Discussions among regulatory agencies are underway that may limit the current and future use of subordinated debentures as Tier I capital. The Company's decision to issue subordinated debentures was in part influenced by potential regulatory actions in the future. The Company anticipates above average growth to continue and anticipates a time in the future when capital ratios are lower and additional capital may be need.

In October of 2008, the Bank entered into an interest rate swap agreement. The agreement called for the Bank to pay a fixed rate of 7.27% until October 8, 2015, on \$10 million and receive payment equal to the three month libor plus 3.10%. The Bank then completed an intercompany transaction that transferred the swap to the Company, providing an effective hedge for its variable rate subordinated debentures. The interest rate swap matured on October 8, 2015.

### **Repurchase Agreements**

The Company offers cash management customers an automated sweep account of excess funds from checking accounts into repurchase accounts. Prior to 2011, this product was the preferred method to provide commercial deposit customers the opportunity to earn interest income on demand deposit accounts. Repurchase balances are overnight borrowings from customers and are not FDIC insured but are fully collateralized by specific securities in the Company's investment portfolio. At December 31, 2015, the Company's retail repurchase agreements total \$39.8 million. In addition, the Company has one term repurchase agreement with a bank secured by investment securities totaling \$6.0 million with an interest rate of 4.36% maturing on September 18, 2016.

### **Subsidiary Activities**

The Bank owns JBMM, LLC, a wholly owned, limited liability company, owns and manages the Bank's other real estate and other assets owned. The Bank owns Heritage Interim Corporation, a Tennessee corporation established to facilitate the acquisition of a bank in Tennessee. The proposed acquisition was terminated in August of 2013. The Bank owns Heritage USA Title, LLC, which sells title insurance to the Bank's real estate loan customers.

The Bank owns Fort Webb LLLP, LLC, , which owns a limited partnership interest in Fort Webb LLLP, a low income senior citizen housing facility in Bowling Green, Kentucky. The facility offers apartments for rent for those senior citizens who qualify and is managed by the Bowling Green, Kentucky Housing Authority. The Company receives tax credits and Community Reinvestment Credits for its \$420,000 investment.

### **Federal Taxation**

The Company and the Bank file a consolidated federal income tax return on a calendar year basis. The Company is subject to the federal tax laws and regulations that apply to corporations generally.

### **Kentucky Taxation**

Kentucky corporations, such as HopFed Bancorp, Inc., are subject to the Kentucky corporation income tax and the Kentucky corporation license ( franchise ) tax. The income tax is imposed based on the following rates: 4% of the first \$50,000 of net taxable income allocated or apportioned to Kentucky; 5% of the next \$50,000; and 6% of taxable net income over \$100,000. All dividend income received by a corporation is excluded for purposes of arriving at taxable net income.

### **Tennessee Taxation**



The Company and all subsidiaries are subject to Tennessee Franchise and Excise tax on apportioned capital and apportioned income.

## **Heritage Bank USA, Inc.**

The Commonwealth of Kentucky imposes both a Kentucky Bank Franchise Tax and Local Deposits Franchise Tax. The Kentucky Bank Franchise Tax is an annual tax equal to 1.1% of net capital after apportionment, if applicable. The value of the net capital is calculated annually by deducting from total capital an amount equal to the same percentage of total as the book value of United States obligations bears to the book value of the total assets of the financial institution. Heritage Bank USA Inc., as a financial institution, is exempt from both corporate income and license taxes.

## **Competition**

The Bank faces significant competition both in originating mortgage and other loans and in attracting deposits. The Bank competes for loans principally on the basis of interest rates, the types of loans it originates, the deposit products it offers and the quality of services it provides to borrowers. The Bank also competes by offering products which are tailored to the local community. Its competition in originating real estate loans comes primarily from other savings institutions, commercial banks and mortgage bankers making loans secured by real estate located in the Bank's market area. Commercial banks, credit unions and finance companies provide vigorous competition in consumer lending. Competition may increase as a result of the continuing reduction of restrictions on the interstate operations of financial institutions.

At June 30, 2015, the Bank had a 12.4% share of the deposit market in its combined markets. The Bank's most significant competition across its entire market area was Planters Bank of Kentucky with a 10.4% deposit market share, Community Financial Services Bank with a 9.3% deposit market share, U.S. Bank N/A with a 8.5% market share, and Branch Bank & Trust of North Carolina with an 7.5% deposit market share and Regions Bank of Birmingham, Alabama with a 7.1% deposit market share. In addition, each market contains other community banks that provide competitive products and services within individual markets.

The Bank attracts its deposits through its eighteen offices primarily from the local community. Consequently, competition for deposits is principally from other savings institutions, commercial banks and brokers in the local community as well as from credit unions. The Bank competes for deposits and loans by offering what it believes to be a variety of deposit accounts at competitive rates, convenient business hours, a commitment to outstanding customer service and a well-trained staff. The Bank believes it has developed strong relationships with local realtors and the community in general.

The Bank is a community and retail-oriented financial institution. Management considers the Bank's branch network and reputation for financial strength and quality customer service as its major competitive advantage in attracting and retaining customers in its market area. A number of the Bank's competitors have been acquired by statewide/nationwide banking organizations. While the Bank is subject to competition from other financial institutions which may have greater financial and marketing resources, management believes the Bank benefits by its community orientation and its long-standing relationship with many of its customers.

## **Employees**

As of December 31, 2015, the Company and the Bank had 243 full-time equivalent employees, none of whom were represented by a collective bargaining agreement. Management considers the Bank's relationships with its employees to be good.

## Executive Officers of the Registrant

**John E. Peck.** Mr. Peck has served as President and Chief Executive Officer of both the Company and the Bank since July 2000. Prior to that, Mr. Peck was President and Chief Executive Officer of United Commonwealth Bank and President of Firststar Bank-Calloway County. Mr. Peck was a past Board Member and Chairman of the Christian County Chamber of Commerce, Jennie Stuart Hospital and Murray-Calloway County Hospital. Mr. Peck holds a Bachelor of Science of Business Administration with a concentration in Finance from the University of Louisville. Mr. Peck is a graduate of the Louisiana State University School of Banking. Mr. Peck is a member and serves on the finance committee of the First Baptist Church of Hopkinsville.

**Michael L. Woolfolk.** Mr. Woolfolk has served as Executive Vice President and Chief Operations Officer of the Bank since August 2000. Mr. Woolfolk was appointed to the Board of Directors of the Company on August 15, 2012. Prior to that, he was President of First-Star Bank-Marshall County, President and Chief Executive Officer of Bank of Marshall County and President of Mercantile Bank. Mr. Woolfolk is a member of First Baptist Church of Hopkinsville.

**Billy C. Duvall.** Mr. Duvall has served as Senior Vice President, Chief Financial Officer and Treasurer of the Company and the Bank since June 1, 2001. Prior to that, he was an Auditor with Rayburn, Betts & Bates, P.C., independent public accountants and nine years as a Principal Examiner with the National Credit Union Administration. Mr. Duvall holds a Bachelor of Business Administration from Austin Peay State University in Accounting and Finance. Mr. Duvall is a Certified Public Accountant of Virginia. Mr. Duvall is the past Board Chairman for the Pennyroyal Mental Health Center, a member of the Hopkinsville Kiwanis club, and a member of Southside Church of Christ in Hopkinsville.

**P. Michael Foley.** Mr. Foley was hired in December 2011 to serve as Senior Vice President, Chief Credit Officer of the Bank. Prior to that, from January 2011 to December 2011, he served as Senior Vice President, Senior Credit Officer in the Special Assets Group of Old National Bank of Evansville, Indiana. From July 2006 through December 2010, Mr. Foley served as Senior Vice President, Senior Credit Officer and Chicago Market Manager for Integra Bank of Evansville, Indiana. Mr. Foley resigned from the Company on January 15, 2016.

**Keith Bennett.** Mr. Bennett has served as Montgomery County, Tennessee Market President for the Bank since November 2005. Prior to that, Mr. Bennett was Vice President of Commercial Lending for Farmers and Merchants Bank and First Federal Savings and Loan, both of Clarksville, Tennessee. Mr. Bennett served seven years as a field examiner with the Office of Thrift Supervision. Mr. Bennett holds a Bachelor of Business Administration in Accounting from the University of Tennessee at Martin.

**Bailey Chip Knight.** Mr. Knight was promoted to Chief Credit Officer on January 15, 2016. Mr. Knight has served as a Market President and Senior Lender of the Company since April 2, 2012. In his position with as Market President, Mr. Knight was responsible for all retail and lending functions in the three office Cheatham County, Tennessee market. As Senior Lender, Mr. Knight's responsibilities included relationships with the Company's largest commercial lending clients as well as assisting other commercial loan officers in the calling and structuring of loan agreements. Prior to April 2012, Mr. Knight was the Regional Executive and Team Lead with Capital Bank and GreenBank, where he was responsible for all retail and lending functions in eight offices located in Northern Middle Tennessee. Mr. Knight has over 25 years of commercial banking experience, all in Middle Tennessee and is a lifelong resident of Montgomery County, Tennessee.

*Ratio of Earnings to Fixed Charges.*

The table below is a Company's computation of earnings to fixed charges for the years ended December 31, 2015, through December 31, 2012 (All dollars in thousands).

	2015	2014	2013	2012
<b><u>Including interest on deposits</u></b>				
Earnings				
Pre-tax income	\$ 2,678	\$ 1,998	\$ 4,406	\$ 4,886
Add: fixed charges from below	6,550	8,879	10,581	14,877
	\$ 9,228	\$ 10,877	\$ 14,987	\$ 19,763
Fixed Charges:				
Total interest expense	\$ 6,550	\$ 8,879	\$ 10,581	\$ 14,877
Preference stock dividend				1,526
Including preference security dividend	\$ 6,550	\$ 8,879	\$ 10,581	\$ 16,403
Ratio of earnings to fixed charges	\$ 1.41	\$ 1.24	\$ 1.42	\$ 1.33
Including preference security dividend	\$ 1.41	\$ 1.24	\$ 1.42	\$ 1.20
<b><u>Excluding interest on deposits</u></b>				
Earnings				
Pre-tax income	\$ 2,678	\$ 1,998	\$ 4,406	\$ 4,886
Add: fixed charges from below	1,519	3,276	3,467	4,306
	\$ 4,197	\$ 5,274	\$ 7,873	\$ 9,192
Fixed Charges:				
Total interest expense excluding interest paid on deposits	\$ 1,519	\$ 3,276	\$ 3,467	\$ 4,306
Preferred stock dividend				1,526
Including preference security dividend	\$ 1,519	\$ 3,276	\$ 3,467	\$ 5,832
Ratio of earnings to fixed charges	\$ 2.76	\$ 1.61	\$ 2.27	\$ 2.13
Including preference security dividend	\$ 2.76	\$ 1.61	\$ 2.27	\$ 1.58

*Limitations on Capital Distributions.* The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which provides that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The FRB also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. In a recent Supervisory Letter, the FRB staff has stated that, as a general matter, bank holding companies should eliminate cash dividends if net income available to shareholders for the past

four quarters, net of dividends previously paid, is not sufficient to fully fund the dividend. Furthermore, under the federal prompt corrective action regulations, the FRB may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as undercapitalized.

## Seasonality of Revenues and Expenses

The Company's business is not materially affected by seasonality fluctuations in our business cycle. The Company's financial health is substantially affected by the overall business cycle and market interest rates.

## Supervision and Regulation

*General.* The Company is a bank holding company registered with the Board of Governors of the FRB System (the FRB). We are subject to examination and supervision by the FRB pursuant to the Bank Holding Company Act of 1956, as amended (the BHCA), and are required to file reports and other information regarding our business operations and the business operations of our subsidiaries with the FRB.

In general, the BHCA and the FRB's regulations limit the nonbanking activities permissible for bank holding companies to those activities that the FRB has determined to be so closely related to banking or managing or controlling banks to be a proper incident thereto. A bank holding company that elects to be treated as a financial holding company, however, may engage in, and acquire companies engaged in, activities that are considered financial in nature, as defined by the Gramm-Leach-Bliley Act and FRB regulations. These activities include, among other things, securities underwriting, dealing and market-making, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, and merchant banking.

A bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the policy of the FRB that a bank holding company should stand ready to use available resources to provide adequate capital to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of the FRB regulations, or both.

As a Kentucky-chartered commercial bank, the Bank is subject to regulation, supervision and examination by the Kentucky Department of Financial Institutions (KDFI) and by the Federal Deposit Insurance Corporation (FDIC), which insures its deposits to the maximum extent permitted by law. The federal and state laws and regulations applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for certain loans. The laws and regulations governing the Bank generally have been promulgated to protect depositors and not for the purpose of protecting stockholders. This regulatory structure also gives the federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the KDFI, the FDIC or the United States Congress, could have a material impact on the Company, the Bank and their operations.

*Dodd-Frank Wall Street Reform and Consumer Protection Act.* The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), enacted in 2010, extensively restructured financial institution regulation in the United States, including through the creation of a new resolution authority, mandating higher capital and liquidity requirements, requiring banks to pay increased fees to regulatory agencies, and through numerous other provisions intended to strengthen the financial services sector. The implications of the Dodd-Frank Act for the Company's businesses will depend to a large extent on the manner in which rules adopted pursuant to the Dodd-Frank Act are implemented by the primary U.S. financial regulatory agencies as well as potential changes in market practices and structures in response to the requirements of the Dodd-Frank Act and financial reforms in other jurisdictions.



The Dodd-Frank Act established the Consumer Financial Protection Bureau, or CFPB, and granted it broad rulemaking, supervisory and enforcement powers under a broad range of federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but are examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB also has the authority to seek to uncover unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, the Dodd-Frank Act allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a qualified mortgage as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

The Dodd-Frank Act also established the Financial Stability Oversight Council, which has oversight authority for monitoring and regulating systemic risk. In addition, the Dodd-Frank Act altered the authority and duties of the federal banking and securities regulatory agencies, implemented certain corporate governance requirements for all public companies, including financial institutions, with regard to executive compensation, proxy access by shareholders, and certain whistleblower provisions, and restricted certain proprietary trading and hedge fund and private equity activities of banks and their affiliates.

New laws or regulations or changes to existing laws and regulations (including changes in interpretation or enforcement) could materially adversely affect our financial condition or results of operations. Certain aspects of the Dodd-Frank Act are subject to further rule making and will take effect over several years. The overall financial impact on us and our subsidiaries or the financial services industry generally cannot be determined at this time.

*Holding Company Capital Requirements.* The FRB has adopted capital adequacy standards pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications to it under the BHCA. The FRB's capital adequacy guidelines are similar to those imposed on the Bank by the FDIC. See -Bank Capital Requirements.

The FRB has adopted a policy statement that generally exempts bank holding companies with less than \$1 billion in consolidated assets from its regulatory capital requirements provided that such companies are not engaged in significant nonbanking activities, do not conduct significant off-balance sheet activities and do not have a material amount of debt or equity securities outstanding that are registered with the SEC. As long as their bank subsidiaries are well capitalized, such bank holding companies need only maintain a pro forma debt to equity ratio of less than 1.0 in order to pay dividends and repurchase stock and to be eligible for expedited treatment on applications. Although our asset size would qualify for the exemption provided by the FRB's policy statement, the Company is subject to consolidated regulatory capital requirements because its equity securities are registered with the SEC.

*Bank Capital Requirements.* Effective January 1, 2015, the Bank became subject to new regulatory capital rules adopted by the FDIC and the other federal bank regulatory agencies to conform U.S. regulatory standards to the international standards agreed to by the Basel Committee on Banking Supervision. The new capital rules (the Basel III Capital Rules), which apply to all depository institutions as well as to all top-tier bank loan holding companies that are not subject to the Federal Reserve Board's Small Bank Holding Company Policy Statement, substantially revised the risk-based capital requirements that previously applied to the Bank.



Among other things, the Basel III Capital Rules establish a new common equity Tier 1 (or CET1) capital requirement (4.5% of risk-weighted assets), sets the minimum leverage ratio for all banking organizations at a uniform 4% of total assets, increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assign 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 Basel III Capital Rules also require 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 out is exercised, establish new limitations on the inclusion in regulatory capital of deferred tax assets and mortgage servicing rights, and expand the recognition of collateral and guarantors in determining risk-weighted assets.

In addition to higher capital requirements, the Basel III Capital Rules require banking organizations to maintain a capital conservation buffer of at least 2.5% of risk-weighted assets over and above the minimum risk-based capital requirements. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement will be phased in over four years beginning January 1, 2016. The fully phased-in capital buffer requirement will effectively raise the minimum required risk-based capital ratios to 7% CET1 capital, 8.5% Tier 1 capital and 10.5% total capital on a fully phased-in basis.

*Prompt Corrective Action.* Under applicable federal statute, the federal bank regulatory agencies are required to take prompt corrective action with respect to institutions that do not meet specified minimum capital requirements. For these purposes, the law establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under the FDIC's prompt corrective action regulations, which were amended to incorporate the new regulatory capital standards implemented by the Basel III Capital Rules, an institution is deemed to be well-capitalized if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 8% or greater, a Tier 1 leverage ratio of 5% or greater, and a common equity Tier 1 ratio of 6.5% or greater and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure. An institution is adequately capitalized if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 6% or greater, a Tier 1 leverage ratio of 4% or greater, and a common equity Tier 1 ratio of 4.5% or greater and the institution does not meet the definition of a well-capitalized institution. An institution is under-capitalized if it does not meet one or more of the adequately-capitalized tests. An institution is deemed to be significantly under-capitalized if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 4%, a Tier 1 leverage ratio that is less than 3%, or a common equity Tier 1 ratio of less than 3%. An institution is deemed to be critically under-capitalized if it has a ratio of tangible equity, as defined in the regulations, to total assets that is equal to or less than 2%.

The prompt corrective action regulations provide for the imposition of a variety of requirements and limitations on institutions that fail to meet the above capital requirements. In particular, the FDIC may require any bank that is not adequately capitalized to take certain action to increase its capital ratios. If the bank's capital is significantly below the minimum required levels of capital or if it is unsuccessful in increasing its capital ratios, the bank's activities may be restricted.

*Deposit Insurance.* The Bank's deposits are insured to applicable limits by the FDIC. Under the Dodd-Frank Act, the maximum deposit insurance amount has been permanently increased from \$100,000 to \$250,000. The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by June 30, 2020. It is intended that insured institutions with assets of \$10 billion or more will fund the increase.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments. Assessments are based on an insured institution's classification among four risk categories determined from their examination ratings and capital and other financial ratios. The institution is assigned to a category and the category determines its assessment rate, subject to certain specified risk adjustments. Insured institutions deemed to pose less risk to the deposit insurance fund pay lower assessments, while greater risk institutions pay higher assessments. In February 2011, the FDIC published a final rule under the Dodd-Frank Act to reform the deposit insurance assessment system. Under such final rule, assessments are based on an institution's average consolidated total assets minus average tangible equity instead of deposits, which was the FDIC's prior practice. The rule revised the assessment rate schedule to establish assessments ranging from 2.5 to 45 basis points, based on an institution's risk classification and possible risk adjustments. Under the FDIC's 2011 final rule, an schedule of substantially lower assessment rates for institutions with total assets of less than \$10 billion will go into effect the quarter after the designated reserve ratio of the Deposit Insurance Fund reaches 1.15%, which the FDIC projects will be the first or second quarter of 2016.

The FDIC has authority to increase insurance assessments. Any significant increases would have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what assessment rates will be in the future.

*Restrictions on Dividends.* The KDFI limits the amount of dividends that can be paid by a state chartered commercial bank to its holding company. The limit is established by adding the current year's net income plus the prior two years net income. The Bank must reduce the amount of accumulated net income over the last two years plus the current year by the amount of dividends paid to the Corporation during the same period of time. At December 31, 2015, the Bank could not pay an additional cash dividend to the Corporation without the prior approval of the KDFI.

Future earnings of the Bank appropriated to bad debt reserves and deducted for federal income tax purposes are not available for payment of dividends or other distributions to the Company without payment of taxes at the then current tax rate by the Bank on the amount of earnings removed from the reserves for such distributions.

*Transactions with Affiliates and Insiders.* Generally, transactions between a bank or its subsidiaries and its affiliates are required to be on terms as favorable to the bank as transactions with non-affiliates. In addition, certain of these transactions, such as loans to an affiliate, are restricted to a percentage of the bank's capital. Affiliates of the Bank include the Company and any company that is under common control with the Bank. In addition, a bank may not acquire the securities of most affiliates. The KDFI and FDIC have the discretion to treat subsidiaries of commercial banks as affiliates on a case-by-case basis.

Certain transactions with directors, officers or controlling persons are also subject to conflict of interest regulations enforced by the KDFI and FDIC. These conflict of interest regulations and other statutes also impose restrictions on loans to such persons and their related interests. Among other things, such loans must generally be made on terms that are substantially the same as for loans to unaffiliated individuals.

*Reserve Requirements.* Pursuant to regulations of the FRB, all FDIC-insured depository institutions must maintain average daily reserves at specified levels against their transaction accounts. The Bank met these reserve requirements at December 31, 2015.



*Federal Home Loan Bank System.* The Federal Home Loan Bank System consists of 12 district Federal Home Loan Banks subject to supervision and regulation by the Federal Housing Finance Board ( FHFB ). The Federal Home Loan Banks provide a central credit facility primarily for member institutions. As a member of the FHLB, the Bank is required to acquire and hold shares of capital stock in the FHLB in an amount at least equal to 1% of the aggregate unpaid principal of its home mortgage loans, home purchase contracts, and similar obligations at the beginning of each year, or 5% of its advances (borrowings) from the FHLB, whichever is greater. The Bank was in compliance with this requirement, with a \$4.4 million investment in FHLB stock at December 31, 2015.

## **Sarbanes Oxley Act of 2002**

The Sarbanes-Oxley Act provided for sweeping changes with respect to corporate governance, accounting policies and disclosure requirements for public companies, and also for their directors and officers. The Sarbanes-Oxley Act required the SEC to adopt new rules to implement the Act s requirements. These requirements include new financial reporting requirements and rules concerning the chief executive and chief financial officers to certify certain financial and other information included in the company s quarterly and annual reports. The rules also require these officers to certify that they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the company s disclosure controls and procedures; and that they have included information in their quarterly and annual filings about their evaluation and whether there have been significant changes to the controls and procedures or other factors which would significantly impact these controls subsequent to their evaluation. The certifications by the Company s Chief Executive Officer and Chief Financial Officer of the financial statements and other information included in this Annual Report on Form 10-K have been filed as exhibits to this Form 10-K. See Item 9A ( Controls and Procedures ) hereof for the Company s evaluation of disclosure controls and procedures.

Pursuant to Section 404 of the Sarbanes-Oxley Act, the Company is required under rules adopted by the SEC to include in its annual reports a report by management on the Company s internal control over financial reporting and an accompanying auditor s report.

## **USA Patriot Act**

The USA Patriot Act authorizes new regulatory powers to combat international terrorism. The provisions that affect financial institutions most directly provide the federal government with enhanced authority to identify, deter, and punish international money laundering and other crimes. Among other things, the USA Patriot Act prohibits financial institutions from doing business with foreign shell banks and requires increased due diligence for private banking transactions and correspondent accounts for foreign banks. In addition, financial institutions have to follow minimum verification of identity standards for all new accounts and are permitted to share information with law enforcement authorities under circumstances that were not previously permitted.

## **Community Reinvestment Act**

The Community Reinvestment Act requires federal bank regulatory agencies to encourage financial institutions to meet the credit needs of low and moderate-income borrowers in their local communities. An institution's size and business strategy determines the type of examination that it will receive. Large, retail-oriented institutions are examined using a performance-based lending, investment and service test. Small institutions are examined using a streamlined approach. All institutions may opt to be evaluated under a strategic plan formulated with community input and pre-approved by the bank regulatory agency.

The Community Reinvestment Act regulations provide for certain disclosure obligations. Each institution must post a notice advising the public of its right to comment to the institution and its regulator on the institution's Community Reinvestment Act performance and to review the institution's Community Reinvestment Act public file. Each lending institution must maintain, for public inspection, a file that includes a listing of branch locations and services, a summary of lending activity, a map of its communities and any written comments from the public on its performance in meeting community credit needs. The Community Reinvestment Act requires public disclosure of a financial institution's written Community Reinvestment Act evaluations. This promotes enforcement of Community Reinvestment Act requirements by providing the public with the status of a particular institution's community reinvestment record.

The Gramm-Leach-Bliley Act made various changes to the Community Reinvestment Act. Among other changes, Community Reinvestment Act agreements with private parties must be disclosed and annual Community Reinvestment Act reports must be made available to a bank's primary federal regulator. A bank holding company will not be permitted to become a financial holding company and no new activities authorized under the Gramm-Leach-Bliley Act may be commenced by a holding company or by a bank financial subsidiary if any of its bank subsidiaries received less than a satisfactory Community Reinvestment Act rating in its latest Community Reinvestment Act examination.

## **Forward-Looking Statements**

This Annual Report on Form 10-K, including all documents incorporated herein by reference, contains forward-looking statements. Additional written or oral forward-looking statements may be made by the Company from time to time in filings with the Securities and Exchange Commission or otherwise. The words "believe," "expect," "seek," and "intend" and similar expressions identify forward-looking statements, which speak only as of the date the statement is made. Such forward-looking statements are within the meaning of that term in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements may include, but are not limited to, projections of income or loss, expenditures, acquisitions, plans for future operations, financing needs or plans relating to services of the Company, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results could differ materially from those set forth in, contemplated by or underlying the forward-looking statements.

The Company does not undertake, and specifically disclaims, any obligation to publicly release the results of revisions which may be made to forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

**Item 1A. RISK FACTORS****The Company could experience an increase in loan losses, which would reduce the Company's earnings.**

As the nation continues to suffer from an economic recession, real estate prices remain under pressure in the Company's market. Furthermore, elevated levels of unemployment have made it difficult for many consumers to meet their monthly obligations. The deployment of military personnel out of Fort Campbell to the Middle East may reduce both demand for and pricing of all types of real estate in the Company's largest market. As a lender, we are exposed to the risk that our customers will be unable to repay their loans according to their terms and that any collateral securing the payment of their loans may not be sufficient to assure repayment. As discussed in Footnote 3 of the Notes to Consolidated Financial Statements, the Company has significant exposure to various types of real estate loans, including commercial real estate, land and land development loans, construction loans, multi-family real estate and loans for residential homes. Credit losses are inherent in the business of making loans and our industry has seen above average loan loss levels for approximately eighteen months. While the Company believes that its loan underwriting standards have been and remain sound, the Company has experienced an increase in charge offs and non-performing loans. To the extent charge offs exceed our financial models, increased amounts charged to the provision for loan losses would reduce net income.

**Rapidly changing interest rate environments could reduce our net interest margin, net interest income, fee income and net income.**

Interest and fees on loans and securities, net of interest paid on deposits and borrowings, are a large part of our net income. Interest rates are the key drivers of the Company's net interest margin and subject to many factors beyond the control of management. As interest rates change, net interest income is affected. Rapid increases in interest rates in the future could result in interest expense increasing faster than interest income because of mismatches in the maturities of the Company's assets and liabilities. Furthermore, substantially higher rates generally reduce loan demand and may result in slower loan growth. Decreases or increases in interest rates could have a negative effect on the spreads between interest rates earned on assets and the rates of interest paid on liabilities, and therefore decrease net interest income. See "Quantitative and Qualitative Disclosures about Market Risk".

**Liquidity needs could adversely affect the Company's results of operations and financial condition.**

The Company relies on dividends from the Bank as a primary source of funds. The Bank's primary source of funds is customer deposits and cash flows from investment instruments and loan repayments. While scheduled loan repayments are a relatively stable source, they are subject to the ability of the borrowers to repay their loans. The ability of the borrowers to repay their loans can be adversely affected by a number of factors, including changes in the economic conditions, adverse trends or events affecting the business environment, natural disasters and various other factors. Cash flows from the investment portfolio may be affected by changes in interest rates, resulting in excessive levels of cash flow during periods of declining interest rates and lower levels of cash flow during periods of rising interest rates. Deposit levels may be affected by a number of factors, including both the national market and local competitive interest rate environment, local and national economic conditions, natural disasters and other various events. Accordingly, the Company may be required from time to time to rely on secondary sources of liquidity to meet withdrawal demands or otherwise fund operations. Such sources include the FHLB advances, brokered deposits and federal funds lines of credit from correspondent banks.

The Company may also pledge investments as collateral to borrow money from third parties. In certain cases, the Company may sell investment instruments for sizable losses to meet liquidity needs, hurting net income. While the Company believes that these sources are currently adequate, there can be no assurance they will be sufficient to meet future liquidity needs.





**The financial industry is very competitive.**

We face competition in attracting and retaining deposits, making loans, and providing other financial services throughout our market area. Our competitors include other community banks, regional and super-regional banking institutions, national banking institutions, and a wide range of other financial institutions such as credit unions, government-sponsored enterprises, mutual fund companies, insurance companies, brokerage companies, and other non-bank businesses. Many of these competitors have substantially greater resources than HopFed Bancorp, Inc.

**Inability to hire or retain certain key professionals, management and staff could adversely affect our revenues and net income.**

We rely on key personnel to manage and operate our business, including major revenue generating functions such as our loan and deposit portfolios. The loss of key staff may adversely affect our ability to maintain and manage these portfolios effectively, which could negatively affect our revenues. In addition, loss of key personnel could result in increased recruiting, hiring, and training expenses, resulting in lower net income.

**Company is subject to extensive regulation that could limit or restrict its activities.**

The Company operates in a highly regulated industry and is subject to examination, supervision, and comprehensive regulation by various federal agencies, including the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation. The Company's regulatory compliance is costly and certain types of activities, including the payment of dividends, mergers and acquisitions, investments, loans and interest rates charged and interest rates paid on deposits and locations of offices are subject to regulatory approval and may be limited by regulation. The Company is also subject to regulatory capital rules established by its regulators, which require it and the Bank to maintain adequate capital to support its and the Bank's growth.

The laws and regulations applicable to the banking industry could change at any time, and the Company cannot predict the effects of these changes on its business and profitability. The Sarbanes-Oxley Act of 2002, and the related rules and regulations promulgated by the Securities and Exchange Commission and NASDAQ National Market that are now and will be applicable to the Company, have increased the scope, complexity, and cost of corporate governance, reporting and disclosure practices. As a result, the Company has experienced, and may continue to experience, greater compliance cost.

On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act is having a broad impact on the financial services industry, including significant regulatory and compliance changes. Many of the requirements called for in the Dodd-Frank Act are being implemented over time and most are subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act are implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on our operations is unclear. The regulatory changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements, increase our regulatory compliance burden or otherwise adversely affect our business.

Further, we may be required to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements under the Dodd-Frank Act. Failure to comply with the new requirements may negatively impact our results of operations and financial condition. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on us, these changes could be materially adverse to our investors.



**Even though the Company's common stock is currently traded on The NASDAQ National Market, the trading volume in the Company's common stock has been low and the sale of substantial amounts of its common stock in the public market could depress the price of the Company's common stock.**

The trading volume of the Company's common stock on The NASDAQ National Market has been relatively low when compared with larger companies listed on The NASDAQ National Market or other stock exchanges. Thinly traded stocks, such as the Company's, can be more volatile than stocks trading in an active public market. Because of this, the Company stockholders may not be able to sell their shares at the volumes, prices, or times that they desire.

The Company cannot predict the effect, if any, that future sales of its common stock in the market, or availability of shares of its common stock for sale in the market, will have on the market prices of the Company's common stock. The Company, therefore, can give no assurance that sales of substantial amounts of its common stock in the market, or the potential for large amounts of sale in the market, would not cause the price of its common stock to decline or impair the Company's ability to raise capital through sales of its common stock.

The market price of the Company's common stock may fluctuate in the future, and these fluctuations may be unrelated to its performance. General market prices declines or overall market volatility in the future could adversely affect the price of the Company's common stock, and the current market price may not be indicative of future market prices.

**The current banking crisis, including the enactment of Emergency Economic Stabilization Action (EESA) and American Recovery and Reinvestment Act (ARRA), have significantly affected our financial condition, results of operations, liquidity or stock price.**

The capital and credit markets have been experiencing volatility and disruption for more than a year. In recent months, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers seeming without regard to that issuer's underlying financial strength.

EESA, which established the TARP, was signed into law in October 2008. As part of TARP, the Treasury established the Capital Purchase Program (CPP) to provide up to \$700 billion of funding to eligible financial institutions through the purchase of preferred shares and other financial instruments with the stated purpose of stabilizing and providing liquidity to the U.S. financial markets.

On February 17, 2009, President Obama signed ARRA, an economic recovery package intended to stimulate the economy and provide for a broad range of infrastructure, energy, health and educational needs. There can be no assurance as to the actual impact that EESA or its programs, including the CPP, and the ARRA or its programs, will have on the national economy or financial markets. The failure of these significant legislative measures to help stabilize the financial markets and the continuation or worsening of current financial market conditions may materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common shares.

**The Company conducts virtually all of its business activities in a geographically concentrated area of Middle and West Tennessee and Western Kentucky.**

The Company operates eighteen offices located in Middle Tennessee and Western Kentucky. The Company maintains significant business relationships in the markets in which it operates as well as the communities adjoining our offices. Therefore, the Company's success is directly tied to the economic viability of our markets which may not be representative of the country as a whole. While the Company believes that its credit quality has been strong given the current environment, continued economic stress in the market may result in an increase in non-performing loans and charge offs. Given the limited geographic footprint of our Company, the economic conditions in our marketplace may

not be reflective of the entire nation.

**Management's analysis of the necessary funding for the allowance for loan loss account may be incorrect or may suddenly change, resulting in lower earnings.**

The funding of the allowance for loan loss account is the most significant estimate made by management in its financial reporting to shareholders and regulators. If negative changes to the performance of the Company's loan portfolio were to occur, management may find it necessary or be required to fund the allowance for loan loss account through additional charges to the Company's provision for loan loss expense. These changes may occur suddenly and be dramatic in nature. These changes are likely to affect the Company's financial performance, capital levels and stock price.

**If the federal funds and interbank funding rates remain at current extremely low levels, our net interest margin, and consequently our net earnings, may be negatively impacted.**

Because of significant competitive pressures in our market and the negative impact of these pressures on our deposit and loan pricing, coupled with the fact that a significant portion of our loan portfolio has variable rate pricing that moves in concert with changes to the Federal Reserve Board of Governors' federal funds rate or the London Interbank Offered Rate (LIBOR) (both of which are at extremely low levels as a result of current economic conditions), our net interest margin may be negatively impacted. Additionally, the amount of non-accrual loans and other real estate owned has been and may continue to be elevated. We also expect loan pricing to remain competitive in 2016 despite the first increase in the federal funds rates in many years and believe that economic factors affecting broader markets will likely result in historically low yields for our investment securities portfolio. As a result, our net interest margin, and consequently our profitability, may continue to be negatively impacted in 2016 and beyond.

**Holders of HopFed Capital Trust I have rights that are senior to those of the Company's common shareholders.**

The Company has issued trust preferred securities from a special purpose trusts and accompanying junior subordinated debentures. At December 31, 2015, HopFed had outstanding trust preferred securities of \$10.3 million. Payments of the principal and interest on the trust preferred securities of these trusts are conditionally guaranteed by the Company. Further, the accompanying junior subordinated debentures HopFed issued to the trusts are senior to our common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on common stock and, in the event of the Company's dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made to the Company's common shareholders. The Company has the right to defer distributions on its junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on its common stock. If our financial condition deteriorates or if we do not receive required regulatory approvals, we may be required to defer distributions on our junior subordinated debentures.

**New capital requirements for bank holding companies and depository institutions may negatively impact our results of operations.**

In July 2013, the Board of Governors of the Federal Reserve Bank approved the final rule for BASEL III capital requirements for all commercial banks chartered in the United States of America. The rule will implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under the final rule, minimum requirements have increased for both the quantity and quality of capital held by banking organizations. Consistent with the international Basel framework, the rule includes a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5% and a common equity tier 1 capital conservation buffer of 2.5% of risk-weighted assets that will apply to all supervised financial institutions. The rule also raises the minimum ratio of tier 1 capital to risk-weighted assets from 4.0% percent to 6.0% percent and includes a minimum leverage ratio of 4.0% for all banking organizations. The transition period for implementation of Basel III was January 1, 2015, through

December 31, 2018. At December 31, 2015, the Company met all capital requirements set forth by Basel III through the final implementation date of December 31, 2018.

The application of more stringent capital requirements for HopFed Bancorp and Heritage Bank, may, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term and increase the cost of our funding, restructure our business models and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying dividends or buying back shares.

**A failure in our operational systems or infrastructure, or those of third parties, could impair our liquidity, disrupt our businesses, result in the unauthorized disclosure of confidential information, damage our reputation and cause financial losses.**

Our businesses are dependent on their ability to process and monitor, on a daily basis, a large number of transactions, many of which are highly complex, across numerous and diverse markets. These transactions, as well as the information technology services we provide to clients, often must adhere to client-specific guidelines, as well as legal and regulatory standards. Due to the breadth of our client base and our geographical reach, developing and maintaining our operational systems and infrastructure is challenging, particularly as a result of rapidly evolving legal and regulatory requirements and technological shifts.

Our financial, accounting, data processing or other operating systems and facilities may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, such as a spike in transaction volume, cyber-attack or other unforeseen catastrophic events, which may adversely affect our ability to process these transactions or provide services.

In addition, our operations rely on the secure processing, storage and transmission of confidential and other information on our computer systems and networks. Although we take protective measures to maintain the confidentiality, integrity and availability of our and our clients' information across all geographic and product lines, and endeavor to modify these protective measures as circumstances warrant, the nature of the threats continues to evolve. As a result, our computer systems, software and networks may be vulnerable to unauthorized access, loss or destruction of data (including confidential client information), account takeovers, unavailability of service, computer viruses or other malicious code, cyber-attacks and other events that could have an adverse security impact. Despite the defensive measures we take to manage our internal technological and operational infrastructure, these threats may originate externally from third parties such as foreign governments, organized crime and other hackers, and outsource or infrastructure-support providers and application developers, or may originate internally from within our organization. Given the increasingly high volume of our transactions, certain errors may be repeated or compounded before they can be discovered and rectified.

We also face the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate our business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, our operational systems, data or infrastructure. In addition, as interconnectivity with our clients grows, we increasingly face the risk of operational failure with respect to our clients' systems.

Although we have not experienced a cyber-incident, if one or more of these events occurs, it could potentially jeopardize the confidential, proprietary and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our, as well as our clients' or other third parties', operations, which could result in damage to our reputation, substantial costs, regulatory penalties and/or client dissatisfaction or loss. Potential costs of a cyber-incident may include, but would not be limited to, remediation costs, increased protection costs, lost revenue from the unauthorized use of proprietary information or the loss of

current and/or future customers, and litigation.

We maintain an insurance policy which we believe provides sufficient coverage at a manageable expense for an institution of our size and scope with similar technological systems. However, we cannot assure that this policy would be sufficient to cover all financial losses, damages, penalties, including lost revenues, should we experience any one or more of our or a third party's systems failing or experiencing attack.



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**The downgrade of the U.S. credit rating and Europe's debt crisis could have a material adverse effect on our business, financial condition and liquidity.**

Standard & Poor's lowered its long term sovereign credit rating on the United States of America from AAA to AA+ on August 5, 2011. A further downgrade or a downgrade by other rating agencies could have a material adverse impact on financial markets and economic conditions in the United States and worldwide. Any such adverse impact could have a material adverse effect on our liquidity, financial condition and results of operations.

In addition, the possibility that certain European Union (EU) member states will default on their debt obligations has negatively impacted economic conditions and global markets. The continued uncertainty over the outcome of international and the EU's financial support programs and the possibility that other EU member states may experience similar financial troubles could further disrupt global markets. The negative impact on economic conditions and global markets could also have a material adverse effect on our liquidity, financial condition and results of operations.

**Our loan portfolio includes loans with a higher risk of loss which could lead to higher loan losses and non-accrual assets.**

We originate commercial real estate loans, construction and development loans, consumer loans, loans secured by farmland and residential mortgage loans primarily within our market area. Commercial real estate, commercial, farmland, and construction and development loans tend to involve larger loan balances to a single borrower or groups of related borrowers and are most susceptible to a risk of loss during a downturn in the business cycle. These loans also have historically had greater credit risk than other loans for the following reasons:

**Non-residential Real Estate Loans.** Repayment is dependent on income being generated in amounts sufficient to cover operating expenses and debt service. These loans also involve greater risk because they may not be fully amortizing over a loan period, but may have a balloon payment due at maturity. A borrower's ability to make a balloon payment typically will depend on being able to either refinance the loan or timely sell the underlying property. As of December 31, 2015, commercial real estate loans and multi-family loans comprised approximately 31.0% of our total loan portfolio, or 175.9% of the Company's total risk based capital. At December 31, 2015, the Company had \$11.4 million of its commercial real estate and multi-family real estate loans classified as substandard which equaled 6.6% of that portfolio and 40.7% of total substandard loans. At December 31, 2015, the Company's allowance for loan losses included \$1.4 million allocated to this portfolio.

**Commercial Loans.** Repayment is generally dependent upon the successful operation of the borrower's business. In addition, the collateral securing the loans may depreciate over time, be difficult to appraise, be illiquid, or fluctuate in value based on the success of the business. As of December 31, 2015, commercial loans comprised approximately 15.4% of our total loan portfolio, or 86.0% of the Company's consolidated total risk based capital. At December 31, 2015, the Company had \$2.1 million of its commercial loan portfolio classified as substandard which equaled 2.4% of that portfolio and 7.4% of total substandard loans. At December 31, 2015, the Company's allowance for loan losses included \$623,000 allocated to this portfolio.

**Construction and Development Loans.** The risk of loss is largely dependent on our initial estimate of whether the property's value at completion equals or exceeds the cost of property construction and the availability of take-out financing. During the construction phase, a number of factors can result in delays or

cost overruns. If our estimate is inaccurate or if actual construction costs exceed estimates, the value of the property securing our loan may be insufficient to ensure full repayment when completed through a permanent loan, sale of the property, or by seizure of collateral. As of December 31, 2015, construction, land and land development loans comprised approximately 10.2% of our total loan portfolio and approximately 56.8% of the Company's consolidated total risk based capital. At December 31, 2015, the Company had \$10.6 million of its construction and development loans classified as substandard which equaled 18.5% of that portfolio and 37.8% of total substandard loans. At December 31, 2015, the Company's allowance for loan losses included \$1.8 million allocated to this portfolio.

**Farmland.** Repayment is generally dependent upon the successful operation of the borrower's farming operation. The typical risk to a farming operation include adverse weather conditions, changes to farm insurance subsidies, declines in commodity prices and sudden increases in the cost of farm production. In addition, the value collateral securing the loans often fluctuates with the long term trends for commodity prices and may rise and fall significantly and may be illiquid in times of declining values. As of December 31, 2015, loans secured by farmland comprised approximately 7.5% of our total loan portfolio, or 41.9% of the Company's consolidated total risk based capital. At December 31, 2015, the Company had \$329,000 of its farmland portfolio classified as substandard which equaled 0.8% of that portfolio and 1.2% of total substandard loans. At December 31, 2015, the Company's allowance for loan losses included \$358,000 allocated to this portfolio.

The increased risks associated with these types of loans result in a correspondingly higher probability of default on such loans (as compared to single-family real estate loans). Loan defaults would likely increase our loan losses and non-accrual assets and could adversely affect our allowance for loan losses.

**Since we engage in lending secured by real estate and may be forced to foreclose on the collateral property and own the underlying real estate, we may be subject to the increased costs associated with the ownership of real property, which could result in reduced net income.**

Since we originate loans secured by real estate, we may have to foreclose on the collateral property to protect our investment and may thereafter own and operate such property, in which case we are exposed to the risks inherent in the ownership of real estate.

The amount that we, as mortgagee, may realize after a default is dependent upon factors outside of our control, including, but not limited to general and local economic conditions, changing values of property, interest rates, unpaid real estate taxes, environmental issues, operating expenses involved with managing other real estate owned, and the supply and demand for units held for sale as well as other unforeseen cost and delays.

Certain expenditures associated with the ownership of real estate, principally real estate taxes and maintenance costs, may adversely affect the income from the real estate. Therefore, the cost of operating real property may exceed the rental income earned from such property, and we may have to advance funds in order to protect our investment or we may be required to dispose of the real property at a loss.

**We face risks arising from acquisitions of either other financial institutions or branch locations.**

From time to time, we may acquire another financial institution in the future. We face a number of risks arising from acquisition transactions, including difficulties in integrating the acquired business into our operations, difficulties in assimilating and retaining employees and intermediaries, difficulties in retaining the existing customers of the acquired entity, unforeseen liabilities that arise in connection with the acquired business and unfavorable market conditions that could negatively impact our growth expectations for the acquired business. These risks may prevent us from realizing the expected benefits from acquisitions and could result in the impairment of goodwill and/or intangible assets recognized at the time of acquisition.

**We face risk from further reductions in the size and makeup of the United States Army staffing at Fort Campbell, Kentucky.**

The U.S. Army has provided a revised assessment of future staffing cuts that indicates that Fort Campbell may lose approximately a small portion of its active duty military personnel by 2020. In November of 2014, the United States Army announced that it was de-activating a combat battalion at Fort Campbell, Kentucky, sending its 2,400 members to other duty stations within the U.S. Army system.

At December 31, 2015, the Company's loan portfolio has approximately \$160.9 million in loans originated from its three Montgomery County, Tennessee offices and \$102.8 million in loans originated in its Christian County, Kentucky offices. The Fort Campbell military installation is the largest employer in the region and a significant reduction in the staffing of the base would have a major negative affect on the economies of Montgomery County, Tennessee and Christian County, Kentucky. The annual cost to the local economy is estimated at nearly \$1 billion.

The Company's management considers growth in the nearby Nashville, Tennessee, market critical for our future success. With the potential for our largest current market to experience an economic downturn, market diversification is vital to the future prosperity of our Company.

**Stockholder activists could cause a disruption to our business.**

Certain institutional investors have indicated that they disagree with the strategic direction of our Company. Our business, operating results or financial condition could be adversely affected by these activists. Any such disruption may result in, among other things:

Increased operating costs, including increased legal expenses, insurance, administrative expenses and associated costs;

Uncertainties as to our future direction could result in the loss of potential business opportunities, make it more difficult to attract, retain, or motivate qualified personnel, and strain relationships with investors and customers; and

Activist investors may reduce or delay our ability to effectively execute our current business strategies and the implementation of new strategies.

**Our cash availability at the holding company level may limit the Company's ability to continue to pay a cash dividend to common shareholders and/or repurchase treasury stock.**

At December 31, 2015, the Corporation has approximately \$2.1 million in cash on hand available to pay common dividends and repurchase treasury stock. At December 31, 2015, the Bank may not pay an additional cash dividend to the Company without regulatory approval. The Bank may not receive regulatory approval to pay the Corporation a dividend, which would limit the Company's ability to repurchase treasury stock and to continue to pay a cash dividend to common shareholders.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

There are no unresolved staff comments from the Securities and Exchange Commission.



**ITEM 2. PROPERTIES**

The following table sets forth information regarding the Bank's offices at December 31, 2015:

	Year Opened	Owned or Leased	Book Value (1) (In thousands)	Approximate Square Footage of Office
<b>Main Office:</b>				
4155 Lafayette Road Hopkinsville, Kentucky	2006	Owned	\$ 4,206	24,072
<b>Branch Offices:</b>				
2700 Fort Campbell Boulevard				
Hopkinsville, Kentucky Downtown Branch Office 605 South Virginia Street	1995	Owned	\$ 1,220	17,625
Hopkinsville, Kentucky Murray South Office 210 N. 12th Street	1997	Owned	\$ 133	756
Murray, Kentucky Murray North Office 1601 North 12 <sup>th</sup> Street	2003	Owned	\$ 1,477	5,600
Murray, Kentucky Cadiz Branch Office 352 Main Street	2007	Owned	\$ 1,056	3,400
Cadiz, Kentucky Elkton Branch Office 536 W. Main Street	1998	Owned	\$ 376	2,200
Elkton, Kentucky Benton Branch Office 105 W. 5 <sup>th</sup> Street	1976	Owned	\$ 81	3,400
Benton, Kentucky Benton Branch Office 660 Main Street	2003	Owned	\$ 464	4,800
Benton, Kentucky Calvert City Office 35 Oak Plaza Drive	2015	Owned	\$ 3,478	n/a
	2003	Owned	\$ 1,055	3,400

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Calvert City, Kentucky  
Carr Plaza Office

607 N. Highland Drive

Fulton, Kentucky	2002	Owned	\$	171	800
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Lake Street Office

306 Lake Street

Fulton, Kentucky	2002	Owned	\$	923	400
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Nashville Loan Production Office

101 Main Street

Nashville, Tennessee	2014	Leased	\$	3	3,200
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Clarksville Main Street

322 Main Street

Clarksville, Tennessee	2007	Owned	\$	1,385	10,000
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Trenton Road Branch

3845 Trenton Road

Clarksville, Tennessee	2006	Owned	\$	2,195	3,362
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Madison Street Office  
2185 Madison Street

Clarksville, Tennessee	2007	Owned	\$	1,366	3,950
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Houston County Office

1102 West Main Street

Erin, Tennessee	2006	Owned	\$	494	2,390
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Ashland City Office

108 Cumberland Street

Ashland City, Tennessee	2006	Owned	\$	1,424	7,058
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Pleasant View Office

2556 Highway 49 East

Pleasant View, Tennessee	2006	Owned	\$	813	2,433
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Kingston Springs Office

104 West Kingston Springs Road

Kingston Springs, Tennessee	2006	Owned	\$	1,714	9,780
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Total	\$ 24,034
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(1) Represents the book value of land, building, furniture, fixtures and equipment owned by the Bank.



**ITEM 3. LEGAL PROCEEDINGS**

From time to time, the Company or the Bank is a party to various legal proceedings incident to its business. At March 1, 2016, there were no legal proceedings to which the Company or the Bank was a party, or to which any of their property was subject, which were expected by management to result in a material loss to the Company or the Bank.

**ITEM 4. MINE SAFETY DISCLOSURE**

None

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUERS PURCHASES OF EQUITY SECURITIES.**

A cash dividend of \$0.04 per share was declared in all four quarters in 2014 and 2015. The high and low price range of the Company's common stock for 2015 and 2014 is set forth below:

	Year Ended December 31, 2015		Year Ended December 31, 2014	
	High	Low	High	Low
First Quarter	\$ 13.86	\$ 12.50	\$ 11.75	\$ 10.97
Second Quarter	\$ 13.09	\$ 11.37	\$ 11.74	\$ 11.21
Third Quarter	\$ 12.14	\$ 10.81	\$ 12.45	\$ 11.35
Fourth Quarter	\$ 12.24	\$ 11.50	\$ 13.04	\$ 11.11

At February 28, 2016, the Company estimates that it has approximately 1,800 shareholders, with approximately 1,200 reported in the name of the shareholder and the remainder recorded in street name.

On March 2, 2015, the Company issued 600,000 shares of treasury stock to establish the Company's ESOP. At December 31, 2015, the Company has 1,085,888 shares of common treasury stock and has an active repurchase plan in which we may purchase up to 252,798 shares of our common stock on the open market or in negotiated transactions.

The following table provides information with respect to purchases made by or on behalf of the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Company's common stock during the three month period ended December 31, 2015:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total number of shares Purchased as part of Publically Announced Programs	Maximum Number of Shares that Yet may be Purchased Under the Program at the end of the period
October 1, 2015, to October 31, 2015		n/a	1,638,686	
November 1, 2015, to November 30, 2015	42,569	\$ 11.79	1,681,255	257,431
December 1, 2015, to December 31, 2015	4,633	\$ 11.52	1,685,888	252,798
Total	47,202	\$ 0.00	1,685,888	252,798

The Federal Reserve Bank has issued a policy statement regarding the payment of dividends and the repurchase of common stock by commercial bank holding companies. In general, dividends should be paid out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital requirements, asset quality and overall financial condition. These regulatory policies may affect the ability of the Company to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

#### ITEM 6. SELECTED FINANCIAL DATA

The information set forth under the caption "Selected Financial Information and Other Data" in the Company's Annual Report to Stockholders for the year ended December 31, 2015, (Exhibit No. 13.1) is incorporated herein by reference. See Note 22 of Notes of Consolidated Financial Statements which is incorporated herein by reference.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The information set forth under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report to Stockholders for the year ended December 31, 2015, (Exhibit No. 13.1) is incorporated herein by reference.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information set forth under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations Interest Rate Sensitivity Analysis in the Company's Annual Report to Stockholders for the year ended December 31, 2015, (Exhibit No. 13.1) is incorporated herein by reference.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The Company's Consolidated Financial Statements together with the related notes and the report of Rayburn I Fitzgerald PC, independent registered public accounting firm, all as set forth in the Company's Annual Report to Stockholders for the year ended December 31, 2015, (Exhibit No. 13.1) are incorporated herein by reference.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None

**ITEM 9A. CONTROLS AND PROCEDURES**

The Company maintains disclosure controls and procedures, as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act) that are designed to insure that information required to be disclosed by it in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified under the SEC's rules and forms and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decision making regarding required disclosure. The Company, under the supervision and participation of its management, including the Company's Chief Executive Officer and the Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report pursuant to the Exchange Act. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that all material information required to be disclosed in this annual report has been accumulated and communicated to them in a manner appropriate to allow timely decisions regarding required disclosures.

## Management Report on Internal Control Over Financial Reporting

The management of HopFed Bancorp, Inc. and its subsidiaries (collectively referred to as the Company) is responsible for the preparation, integrity and fair presentation of published financial statements and all other information presented in this annual report. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and, as such, include amounts based on informed judgments and estimates made by management.

Management is responsible for establishing and maintaining adequate internal control over financial reporting for financial presentations in conformity with GAAP. Pursuant to the rules and regulations of the Securities and Exchange Commission, internal control over financial reporting is a process designed by, or under the supervision of, the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and included those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company.

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and Directors of the Company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations, including the possibility of human error and the circumvention of overriding controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, or that the degree of compliance with the policies and procedures include in such controls may deteriorate.

Management has evaluated the effectiveness of its internal control over financial reporting as of December 31, 2015, based on the control criteria established in a report entitled *Internal Control – Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such evaluation, we have concluded that HopFed Bancorp's internal control over financial reporting is effective as of December 31, 2015.

Rayburn | Fitzgerald PC, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on the effective of the Company's internal control over financial reporting as of December 31, 2015. The report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2015, is included in this Item under the heading Report of Independent Registered Public Accounting Firm.

By: (signed) John E. Peck  
John E. Peck

President and Chief Executive Officer

By: (signed) Billy C. Duvall  
Billy C. Duvall  
Senior Vice President and Treasurer  
(Principal Financial Officer)

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

of HopFed Bancorp, Inc.

Hopkinsville, Kentucky

We have audited HopFed Bancorp, Inc. and subsidiaries (the Company) internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of HopFed Bancorp, Inc. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2015, and our report dated March 3, 2016, expressed an unqualified opinion on those consolidated financial statements.

(signed) Rayburn I Fitzgerald PC

Brentwood, Tennessee

March 3, 2016

**ITEM 9B. OTHER INFORMATION**

Not Applicable

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE OF THE REGISTRANT**

Information regarding directors of the Company is omitted from this Report as the Company will file a definitive proxy statement (the Proxy Statement ) not later than 120 days after December 31, 2015, and the information included therein under Proposal I Election of Directors is incorporated herein by reference. Information regarding the executive officers of the Company is included under separate caption in Part I of this Form 10-K

Information regarding Section 16(a) beneficial ownership reporting compliance is omitted from this Report as the Company will file the Proxy Statement not later than 120 days after December 31, 2015, and the information included therein under Section 16(a) Beneficial Ownership Reporting Compliance is incorporated herein by reference.

Information regarding audit committee financial expert compliance is omitted from this Report as the Company will file the Proxy Statement not later than 120 days after December 31, 2015, and the information contained therein under Committees of the Board of Directors is incorporated herein by reference.

The Company has adopted a code of ethics that applies to all directors and employees, including without exception, the principal executive officer, principal financial officer, principal accounting officer and controller, or persons performing similar functions.

**ITEM 11. EXECUTIVE COMPENSATION**

Information regarding executive compensation is omitted from this Report as the Company will file the Proxy Statement not later than 120 days after December 31, 2015, and the information included therein under Proposal I Election of Directors is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information required by this Item is omitted from this Report as the Company will file the Proxy Statement not later than 120 days after December 31, 2015, and the information included therein under Voting Securities and Principal Holders Thereof and Proposal I Election of Directors is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

Information required by this Item is omitted from this Report as the Company will file the Proxy Statement, not later than 120 days after December 31, 2015, and the information included therein under Proposal I Election of Directors is incorporated herein by reference.





#### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information required by this item is omitted from this report as the Company will file the Proxy Statement not later than 120 days after December 31, 2015, and the information included therein under Independent Registered Public Accounting Firm is incorporated herein by reference.

### **PART IV**

#### **ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) The following consolidated financial statements of the Company included in the Annual Report to Stockholders for the year ended December 31, 2015, are incorporated herein by reference in Item 8 of this Report. The remaining information appearing in the Annual Report to Stockholders is not deemed to be filed as part of this Report, except as expressly provided herein.

1. Report of Independent Registered Public Accounting Firm.
2. Consolidated Balance Sheets - December 31, 2015 and December 31, 2014.
3. Consolidated Statements of Income for the Years Ended December 31, 2015, 2014 and 2013.
4. Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2015, 2014 and 2013.
5. Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2015, 2014 and 2013.
6. Consolidated Statements of Cash Flows for the Years Ended December 31, 2015, 2014 and 2013.
7. Notes to Consolidated Financial Statements.

(b) The following exhibits either are filed as part of this Report or are incorporated herein by reference:

Exhibit No. 2.1. Plan of Conversion of Hopkinsville Federal Savings Bank. Incorporated herein by reference to Exhibit No. 2 to Registrant's Registration Statement on Form S-1 (File No. 333-30215).

Exhibit No. 3.1. Certificate of Incorporation. Incorporated herein by reference to Exhibit No. 3.1 to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

Exhibit No. 3.2 Bylaws, as amended. Incorporated herein by reference to Exhibit No. 3.1 to Registrant's Current Report on Form 8-K dated March 1, 2015 (filed on March 4, 2015).

Exhibit No. 4.1. Form of Common Stock Certificate incorporated herein by reference to Exhibit No. 4.1 to Registrant's Registration Statement on Form S-1 (File No. 333-30215).

Exhibit No. 10.1. HopFed Bancorp, Inc. Management Recognition Plan. Incorporated herein by reference to Exhibit 99.1 to Registration Statement on Form S-8 (File No. 333-79391).

Exhibit No. 10.2. HopFed Bancorp, Inc. 1999 Stock Option Plan. Incorporated herein by reference to Exhibit 99.2 to Registration Statement on Form S-8 (File No. 333-79391).

Exhibit No. 10.3. HopFed Bancorp, Inc. 2000 Stock Option Plan. Incorporated herein by reference to Exhibit 10.10 to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

Exhibit No. 10.4 HopFed Bancorp, Inc. 2004 Long Term Incentive Plan. Incorporated herein by reference to Exhibit 99.3 to Registration Statement on Form S-8 (File No. 333-117956) dated August 5, 2004.

Exhibit No. 10.5 HopFed Bancorp, Inc. 2013 Long Term Incentive Plan. Incorporated herein by reference to Exhibit 99.3 to Registration Statement on Form S-8 (File No. 333-117956) dated June 28, 2013.

Exhibit No. 10.6. Employment Agreement by and between Registrant and John E. Peck. Incorporated herein by reference to Exhibit No. 10.2 to Registrant's Current Report on Form 8-K dated April 17, 2008 (filed April 22, 2008).

Exhibit No. 10.7. Employment Agreement by and between Heritage Bank and John E. Peck. Incorporated herein by reference to Exhibit No. 10.2 to Registrant's Current Report on Form 8-K dated April 1, 2008 (filed April 22, 2008).

Exhibit No. 10.8. Employment Agreement by and between Registrant and Billy C. Duvall. Incorporated herein by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K dated July 1, 2013 (filed July 1, 2013).

Exhibit No. 10.9. Employment Agreement by and between Heritage Bank and Billy C. Duvall. Incorporated herein by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K dated July 1, 2013 (filed July 1, 2013).

Exhibit No. 10.10. Employment Agreement by and between Registrant and Michael L. Woolfolk. Incorporated herein by reference to Exhibit 10.3 to Registrant's Current Report on Form 8-K dated April 17, 2008 (filed April 22, 2008).

Exhibit No. 10.11. Employment Agreement by and between Heritage Bank and Michael L. Woolfolk. Incorporated herein by reference to Exhibit 10.4 to Registrant's Current Report on Form 8-K dated March 18, 2015 (filed March 18, 2015).

Exhibit No. 10.12 Employment Agreement by and between Registrant and P. Michael Foley. Incorporated herein by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K dated March 18, 2015 (filed March 20, 2015).

Exhibit No. 10.13 Amended and Restated Employment Agreement by and between Heritage Bank USA, Inc. and P. Michael Foley. Incorporated herein by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K dated March 18, 2015 (filed March 20, 2015).

Exhibit No. 10.13 Employment Agreement by and between Heritage Bank and Keith Bennett. Incorporated herein by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K dated April 25, 2013 (filed April 25, 2013).

Exhibit No. 10.14 Restricted Share Award Agreement with John E. Peck. Incorporated herein by reference to Registrant's Current Report on Form 8-K dated June 23, 2010 (filed June 28, 2010).

Exhibit No. 10.15 Restricted Share Award Agreement with John E. Peck and Michael Foley. Incorporated herein by reference to Exhibits 10.1 and 10.2, respectively, to Registrant's Current Report on Form 8-K dated June 23, 2012 (filed June 25, 2012).

Exhibit No. 10.16 Employee Stock Ownership Plan. Incorporated herein by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K dated February 27, 2015 (filed March 3, 2015).

Exhibit No. 10.17 Employee Stock Ownership Trust. Incorporated herein by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K dated February 27, 2015 (filed March 3, 2015).



Exhibit No. 99.1 Stock Purchase Agreement with Maltese Capital Management. Incorporated herein by reference to Exhibit 99.1 to Registrant's Current Report on 8-K dated February 2, 2015 (filed February 3, 2015)

Exhibit No. 99.2 Standstill Agreement. Incorporated herein by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K/A dated February 2, 2015 (filed February 4, 2015).

Exhibit No. 13.1. Annual Report to Stockholders Except for those portions of the Annual Report to Stockholders for the year ended December 31, 2015, which are expressly incorporated herein by reference, such Annual Report is furnished for the information of the Commission and is not to be deemed filed as part of this Report.

Exhibit No. 14.1. Code of Ethics. Incorporated herein by reference to Exhibit 14 to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

Exhibit No. 21.1 Subsidiaries of the Registrant.

Exhibit No. 23.1. Consent of Independent Registered Public Accounting Firm.

Exhibit No. 31.1 Certification of Principal Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a).

Exhibit No. 31.2 Certification of Principal Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a).

Exhibit No 32.1. Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit No 32.2. Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101. The following materials from the Company's annual report on Form 10-K for the years ended December 31, 2015 and December 31, 2014, formatted in XBRL (eXtensible Business Reporting Language):  
(i) Condensed Consolidated Statement of Financial Condition as of December 31, 2015 and December 31, 2014,  
(ii) Condensed Consolidated Statements of Income for the years ended December 31, 2015, 2014 and 2013, respectively (iii) Condensed Statements of Comprehensive Income (Loss) for the years ended December 31, 2015, 2014, and 2013, respectively (iv) Condensed Consolidated Statements of Cash Flows, for the years ended December 31, 2015, 2014 and 2013 respectively, and (v) Notes to Condensed Consolidated Financial Statements (unaudited), tagged as blocks of text.

(c) All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on behalf of the undersigned, thereunto duly authorized.

HOPFED BANCORP, INC.  
(Registrant)

Date: March 9, 2016

By: (signed) John E. Peck

John E. Peck  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated and on the dates indicated.

DATE: SIGNATURE AND TITLE:

(signed) John E. Peck John E. Peck Director, President and Chief Executive Officer (Principal Executive Officer)	March 9, 2016
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(signed) Billy C. Duvall Billy C. Duvall Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	March 9, 2016
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(signed) Dr. Harry J. Dempsey Dr. Harry J. Dempsey Chairman of the Board	March 9, 2016
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(signed) Steve Hunt Steve Hunt Vice-Chairman of the Board	March 9, 2016
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(signed) Michael Woolfolk Michael Woolfolk Director, Board Secretary and Executive Vice President and Chief Operating Officer	March 9, 2016
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(signed) Dr. Thomas I. Miller Dr. Thomas I. Miller Director	March 9, 2016
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(signed) Robert Bolton Robert Bolton Director	March 9, 2016
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(signed) Ted Kinsey  
Ted Kinsey Director

March 9, 2016

(signed) Clay Smith  
Clay Smith Director

March 9, 2016

(signed) Robert Perkins  
Richard Perkins Director

March 9, 2016