TF FINANCIAL CORP
Form 10-K
March 29, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

PURSUANT TO SECTIONS 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended December 31, 2006

or

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

For the transition period from to

Commission file number: 0-24168

TF FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**74-2705050**

(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3 Penns Trail, Newtown, Pennsylvania	**18940**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s telephone number, including area code: **(215) 579-4000**

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 $.10 per share

(Title of Class)

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. YES o NO x

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

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant, based on the closing price of the registrant s Common Stock as quoted on the Nasdaq System on June 30, 2006, was $58.5 million (2,870,485 shares at $28.85 per share).

As of March 19, 2007 there were outstanding 2,928,005 shares of the registrant s Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders for the Fiscal Year Ended December 31, 2006. (Parts I, II and IV)

2. Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders. (Part III)

PART I

TF FINANCIAL CORPORATION (THE COMPANY) MAY FROM TIME TO TIME MAKE WRITTEN OR ORAL FORWARD-LOOKING STATEMENTS , INCLUDING STATEMENTS CONTAINED IN THE COMPANY S FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION (INCLUDING THIS ANNUAL REPORT ON FORM 10-K AND THE EXHIBITS HERETO), IN ITS REPORTS TO STOCKHOLDERS AND IN OTHER COMMUNICATIONS BY THE COMPANY, WHICH ARE MADE IN GOOD FAITH BY THE COMPANY PURSUANT TO THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.

THESE FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES, SUCH AS STATEMENTS OF THE COMPANY S PLANS, OBJECTIVES, EXPECTATIONS, ESTIMATES AND INTENTIONS, THAT ARE SUBJECT TO CHANGE BASED ON VARIOUS IMPORTANT FACTORS (SOME OF WHICH ARE BEYOND THE COMPANY S CONTROL). THE FOLLOWING FACTORS, AMONG OTHERS, COULD CAUSE THE COMPANY S FINANCIAL PERFORMANCE TO DIFFER MATERIALLY FROM THE PLANS, OBJECTIVES, EXPECTATIONS, ESTIMATES AND INTENTIONS EXPRESSED IN SUCH FORWARD-LOOKING STATEMENTS: THE STRENGTH OF THE UNITED STATES ECONOMY IN GENERAL AND THE STRENGTH OF THE LOCAL ECONOMIES IN WHICH THE COMPANY CONDUCTS OPERATIONS; THE EFFECTS OF, AND CHANGES IN, MONETARY AND FISCAL POLICIES AND LAWS, INCLUDING INTEREST RATE POLICIES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, INFLATION, INTEREST RATES, MARKET AND MONETARY FLUCTUATIONS; THE TIMELY DEVELOPMENT OF AND ACCEPTANCE OF NEW PRODUCTS AND SERVICES OF THE COMPANY AND THE PERCEIVED OVERALL VALUE OF THESE PRODUCTS AND SERVICES BY USERS, INCLUDING THE FEATURES, PRICING AND QUALITY COMPARED TO COMPETITORS PRODUCTS AND SERVICES; THE IMPACT OF CHANGES IN FINANCIAL SERVICES LAWS AND REGULATIONS (INCLUDING LAWS CONCERNING TAXES, BANKING, SECURITIES AND INSURANCE); TECHNOLOGICAL CHANGES; ACQUISITIONS; CHANGES IN CONSUMER SPENDING AND SAVING HABITS; AND THE SUCCESS OF THE COMPANY AT MANAGING THE RISKS INVOLVED IN THE FOREGOING.

THE COMPANY CAUTIONS THAT THE FOREGOING LIST OF IMPORTANT FACTORS IS NOT EXCLUSIVE. THE COMPANY DOES NOT UNDERTAKE TO UPDATE ANY FORWARD-LOOKING STATEMENT, WHETHER WRITTEN OR ORAL, THAT MAY BE MADE FROM TIME TO TIME BY OR ON BEHALF OF THE COMPANY.

Item 1. Business

BUSINESS OF THE COMPANY

On July 13, 1994, the Company consummated its public offering for 5,290,000 shares of its common stock and acquired Third Federal Bank (the Bank) as part of the Bank s mutual-to-stock conversion. The Company was incorporated under Delaware law in March 1994. The Company is a savings and loan holding company and is subject to regulation by the Office of Thrift Supervision (the OTS), the Federal Deposit Insurance Corporation (the FDIC) and the Securities and Exchange Commission (the SEC). The Company does not transact any material business other than through its direct and indirect subsidiaries: Third Federal Bank, TF Investments Corporation, Teragon Financial Corporation, Penns Trail Development Corporation and Third Delaware Corporation. At December 31, 2006, the Company had total assets of $653 million, total liabilities of $587 million and stockholders equity of $66 million.

BUSINESS OF THE BANK

The Bank is a federally-chartered stock savings bank, which was originally chartered in 1921 as a Pennsylvania-chartered building and loan association. The Bank s deposits are insured up to the maximum amount allowable by the FDIC.

The Bank is a community oriented savings institution offering a variety of financial services to meet the needs of the communities it serves. As of December 31, 2006 the Bank operated fifteen branch offices in Bucks and

Philadelphia counties, Pennsylvania and in Mercer County, New Jersey.

The Bank attracts deposits from the general public and uses such deposits, together with borrowings and other funds primarily to originate or purchase loans secured by first mortgages on owner-occupied, one-to-four family residences in its market area and to invest in mortgage-backed and investment securities. At December 31, 2006, one-to-four family residential mortgage loans totaled $268 million or 55% of the Bank s total loan portfolio. At that same date, the Bank had approximately $82 million or 13% of total assets invested in mortgage-backed securities and $35 million or 5% of total assets in investment securities. The Bank also originates commercial real estate and multi-family, construction and consumer loans. The Bank has two subsidiaries, Third Delaware Corporation, which was incorporated in 1998 for the purpose of holding and managing mortgage-backed securities and investment securities for the Bank, and Teragon Financial Corporation which holds a 75% limited partnership interest in a captive title insurance agency, Third Fed Abstract, L. P. During 2006, Teragon Financial Corporation was granted approval by the state of Pennsylvania to conduct business as an insurance agency.

Market Area

The Bank offers a wide range of consumer and business products at its fifteen full service branch offices located in Bucks and Philadelphia Counties in Pennsylvania, and Mercer County in New Jersey. Five of the branch offices are located in Bucks County, the third wealthiest county in Pennsylvania. Bucks County is a growing region offering opportunity for growth for the Bank. Seven branches are located in the northeast section of Philadelphia where the Bank was founded. Although Philadelphia County is experiencing population decline, the Bank s branches in this section of Philadelphia represent a deposit stronghold. The remaining three branches are in Mercer County, New Jersey which has an expanding population and represents another growth area for the Bank.

Competition

The Bank faces varying degrees of competition from banks, thrift institutions and credit unions at its various branch locations. Stronger competition has come from local and very large regional commercial banks based in and around the Philadelphia area. Based upon the latest available data, at June 30, 2006 the Company s share of deposits in each of the counties in which it operates was as follows:

County, State	Market Share for Entire County		Market Share for ZIP Codes Including Company Branches	
Philadelphia, Pennsylvania	0.5	%	10.9	%
Bucks, Pennsylvania	1.6	%	6.2	%
Mercer, New Jersey	0.8	%	4.6	%

Lending Activities

General. The Bank s loan portfolio composition consists primarily of conventional adjustable-rate (ARM) and fixed-rate first mortgage loans secured by one-to-four family residences. The Bank also makes commercial real estate and multi-family loans, construction loans and consumer and other loans. At December 31, 2006, the Bank s mortgage loans outstanding were $396 million, of which $268 million were secured by first mortgages on one-to-four family residential property. Of the one-to-four family residential mortgage loans outstanding at that date, 19% were ARM s and 81% were fixed-rate loans. Total ARM loans in the Bank s residential mortgage portfolio at December 31, 2006 amounted to $51 million or 11% of total loans. At that same date, commercial real estate and multi-family residential loans totaled $94 million, and construction loans totaled $35 million. The construction loans are predominately floating-rate, prime-rate-based loans.

Consumer and other loans held by the Bank totaled $50 million or 10% of total loans outstanding at December 31, 2006, of which $47 million consisted of home equity and second mortgage loans. At that same date commercial business loans and leases totaled $40 million or 8% of total loans.

The following table sets forth the composition of the Bank s loan portfolio and mortgage-backed and related securities portfolios in dollar amounts and in percentages of the respective portfolios at the dates indicated.

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	At December 31, 2006 Amount	Percent of Total	2005 Amount	Percent of Total	2004 Amount	Percent of Total	2003 Amount	Percent of Total	2002 Amount	Percent of Total
	(Dollars in thousands)									
Loans held for investment:										
Mortgage loans:										
One-to-four family	$ 266,789	54.91 %	$ 289,678	58.76 %	$ 283,965	64.08 %	$ 276,849	68.22 %	$ 227,953	61.33 %
Commercial real estate and multi-family	93,607	19.26	89,489	18.15	83,559	18.86	74,109	18.26	85,493	23.00
Construction	34,944	7.19	24,888	5.04	10,286	2.32	6,591	1.62	12,026	3.23
Total mortgage loans	395,340	81.36	404,055	81.95	377,810	85.26	357,549	88.10	325,472	87.56
Consumer loans:										
Home equity and second mortgage	46,864	9.65	37,479	7.60	29,522	6.66	25,199	6.21	25,480	6.87
Other consumer	3,206	0.66	2,836	0.58	4,384	0.99	6,532	1.61	10,490	2.82
Total consumer and other loans	50,070	10.31	40,315	8.18	33,906	7.65	31,731	7.82	35,970	9.69
Commercial loans and leases:										
Commercial loans	40,458	8.33	48,471	9.83	30,543	6.90	15,185	3.74	8,005	2.15
Commercial leases	36		186	0.04	857	0.19	1,371	0.34	2,246	0.60
Total commercial loans and leases	40,494	8.33	48,657	9.87	31,400	7.09	16,556	4.08	10,251	2.75
Total loans	485,904	100.00 %	493,027	100.00 %	443,116	100.00 %	405,836	100.00 %	371,693	100.00 %
Less:										
Unearned discount, (premium), deferred loan fees, net	(531)		(505)		(706)		(924)		(446)	
Allowance for loan losses	2,865		2,641		2,307		2,111		2,047	
Total loans, held for investment, net	$ 483,570		$ 490,891		$ 441,515		$ 404,649		$ 370,092	
Loans held for sale:										
Mortgage loans:										
One-to-four family	$ 969	100.00 %	$ 68	100.00 %	$ 680	100.00 %		%		%
Total loans held for sale	$ 969	100.00 %	$ 68	100.00 %	$ 680	100.00 %		%		%
Mortgage-backed securities held-to-maturity:										
FHLMC	$ 2,297	29.84 %	$ 3,161	31.06 %	$ 5,195	34.87 %	$ 8,407	35.58 %	$ 21,870	40.10 %
FNMA	3,084	40.07	3,969	39.00	5,182	34.77	7,205	30.49	11,781	21.60
GNMA	2,316	30.09	3,040	29.87	4,516	30.31	8,007	33.88	18,278	33.40
Real estate investment mortgage conduit			7	0.07	7	0.05	11	0.05	2,519	4.60
Other mortgage-backed securities									144	0.30
Total mortgage-backed and related securities held-to-maturity	$ 7,697	100.00 %	$ 10,177	100.00 %	$ 14,900	100.00 %	$ 23,630	100.00 %	$ 54,592	100.00 %
Mortgage-backed securities available-for-sale:										
FHLMC	$ 7,888	10.61 %	$ 9,686	11.60 %	$ 6,614	6.38 %	$ 8.525	7.98 %	$ 699	0.60 %
FNMA	10,330	13.90	12,173	14.58	15,108	14.58	18,385	17.22	11,878	10.30
Real estate investment mortgage conduit	56,120	75.49	61,652	73.82	81,888	79.04	79,864	74.80	102,666	89.10
Total mortgage-backed and related securities available-for-sale	$ 74,338	100.00 %	$ 83,511	100.00 %	$ 103,610	100.00 %	$ 106,774	100.00 %	$ 115,243	100.00 %

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Loan Maturity and Repricing Information. The following table sets forth certain information at December 31, 2006, regarding the dollar amount of loans maturing in the Bank s loan and mortgage-backed securities portfolios based on their maturity date. Demand loans, loans having no stated schedule of repayments and no stated maturity, overdrafts and delinquent loans maturing prior to December 31, 2007, are reported as due in one year or less. The table does not include prepayments or scheduled principal repayments.

	Due 1/1/07 - 12/31/07 (In thousands)	Due 1/1/08 - 12/31/11	Due After 12/31/11
Available for sale:			
Mortgage-backed securities	$ 1,478	$ 86	$ 72,774
Loans receivable			969
Total	$ 1,478	$ 86	$ 73,743
Held to Maturity:			
One-to-four family	$ 148	$ 4,912	$ 261,729
Commercial real estate and multi-family	3,807	10,450	79,350
Construction	25,821	9,123	
Consumer and other	1,172	5,355	43,543
Commercial loans and leases	26,587	5,395	8,512
Total loans receivable	57,535	35,235	393,134
Mortgage-backed securities	144	451	7,102
Total	$ 57,679	$ 35,686	$ 400,236

The following table sets forth the dollar amount of all loans and mortgage-backed securities due after December 31, 2007, which have predetermined interest rates and which have floating or adjustable interest rates. Loans which have rate adjustments after ten years are considered to have predetermined rates.

	Predetermined Rates (In thousands)	Floating or Adjustable Rate
Available for sale:		
Mortgage-backed securities	$ 72,860	$
Loans	969	
Total	$ 73,829	$
Held to Maturity:		
One-to-four family	$ 215,162	$ 51,479
Commercial real estate and multi-family	7,166	82,634
Construction		9,123
Consumer and other	32,950	15,948
Commercial loans and leases	11,363	2,544
Total loans receivable	266,641	161,728
Mortgage-backed securities	7,513	40
Total	$ 274,154	$ 161,768

One-to-Four Family Mortgage Lending. The Bank offers first mortgage loans secured by one-to-four family residences in the Bank s lending area. Typically, such residences are single-family homes that serve as the primary residence of the owner. The Bank generally originates and invests in one-to-four family residential mortgage loans in amounts up to 80% of the lesser of the appraised value or selling price of the mortgaged property. Loans originated in amounts over 80% of the lesser of the appraised value or selling price of the mortgaged property, other than loans to facilitate the sale of real estate acquired through foreclosure, must be owner-occupied and private mortgage insurance is typically required.

Loan originations are obtained from existing or past customers, members of the local community, and referrals from established builders and realtors within the Bank s lending area using direct advertising in local newspapers, branch signage and promotions, and word of mouth referrals.

The Bank offers a variety of ARM loans with terms of 30 years which adjust at the end of 6 months, one, three, five, seven and ten years and adjust by a maximum of 3% to 5% per adjustment with a lifetime cap of 5% to 6% over the life of the loan.

The Bank offers fixed-rate mortgage loans with terms of 10 to 30 years, which are payable monthly. Interest rates charged on fixed-rate mortgage loans are competitively priced based on market conditions. The origination fees for fixed-rate loans range from 0% to 3% depending on the underlying loan coupon. Generally, the Bank s standard underwriting guidelines for fixed-rate mortgage loans conform to the FHLMC and FNMA guidelines. The Bank sells a portion of its conforming fixed-rate mortgage loan originations in the secondary market to FHLMC and FNMA while retaining the servicing rights on these loans. The Bank also brokers a small portion of its loan closings to correspondents. However, the Bank is primarily a portfolio lender. As of December 31, 2006, the Bank s portfolio of loans serviced for FHLMC or FNMA totaled approximately $23 million.

The Bank has a mortgage lending department that is separate as to its sales efforts from the consumer lending area of the Bank. This department employs a lending manager and several commissioned loan officers. Through this department the Bank offers, in addition to its standard portfolio loan products, other types of mortgage loans that are originated in the name of, or sold on a servicing released basis to, third party investors. The mortgage loan officers support the Bank s branches and customers, and additionally engage in calling efforts directed toward realtors, builders, and others that can be sources of lending business for the Bank.

Commercial Real Estate and Multi-Family Lending. The Bank originates loans secured by commercial real estate including non-owner occupied residential multi-family dwelling units (more than four units) primarily secured by professional office buildings and apartment complexes. The Bank generally originates commercial real estate and multi-family loans up to 75% of the appraised value of the property securing the loan. Currently, it is the Bank s philosophy to originate commercial real estate and multi-family loans primarily on properties in its general market area. The commercial real estate and multi-family loans in the Bank s portfolio consist of fixed-rate, ARM and balloon loans originated at prevailing market rates for terms of up to 25 years. The Bank s current policy is to originate commercial real estate and multi-family loans as ARM s that amortize over a 20 to 25 year period and either have a scheduled interest rate reset, or are callable by the Bank after a 5 to 10 year period.

Loans secured by commercial and multi-family real estate are generally larger and involve a greater degree of risk than one-to-four family residential mortgage loans. Of primary concern in commercial and multi-family real estate lending is the borrower s creditworthiness and the feasibility and cash flow potential of the project. Loans secured by income properties are generally larger and involve greater risks than residential mortgage loans because payments on loans secured by income properties are often dependent on successful operation or management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. In order to monitor cash flows on income properties, the Bank requires borrowers and loan guarantors, if any, to provide annual financial statements and rent rolls on multi-family loans. Similarly, on commercial office buildings and hotel properties, the Bank requires minimum debt service coverage and obtains operating statements of such properties. At December 31, 2006, the five largest commercial real estate and multi-family loans totaled $24 million with no single loan larger than $6 million. At December 31, 2006, all such loans were current and the properties securing such loans are in the Bank s market area.

Construction Lending. At December 31, 2006, the Bank had $35 million of construction loans or 7% of the Bank s total loan portfolio. Construction financing is generally 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 required to advance funds beyond the amount originally committed to permit completion of the construction. If the estimate of value 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. At December 31, 2006, the five largest construction loans totaled $18 million with no single loan larger than $5 million.

Consumer and Other Loans. The Bank also offers consumer and other loans in the form of home equity and second mortgage loans (referred to hereinafter collectively as second mortgage loans), automobile loans and student loans. These loans totaled $50 million or 10% of the Bank s total loan portfolio at December 31, 2006. The Bank originates consumer loans in order to provide a wide range of financial services to its customers and because the shorter terms and normally higher interest rates on such loans help maintain a profitable spread between its average loan yield and its cost of funds.

In connection with consumer loan applications, the Bank verifies the borrower s income and reviews a credit bureau report. In addition, the relationship of the loan to the value of the collateral is considered. All automobile loan applications are reviewed and approved by the Bank. The Bank reviews the credit report of the borrower as well as the value of the vehicle which secures the loan.

Consumer loans tend to be originated at higher interest rates than conventional residential mortgage loans and for shorter terms, thus facilitating the Bank s interest rate risk management. Consumer loans, however, tend to have a higher risk of default than residential mortgage loans. At December 31, 2006, $68,000 or 0.1% of the Bank s consumer loans were delinquent more than 90 days, compared to $141,000 or 0.05% of residential one-to-four family loans.

The Bank offers second mortgage loans on one-to-four family residences. At December 31, 2006, second mortgage and home equity loans totaled $47 million, or 10% of the Bank s total loan portfolio. Second mortgage loans are offered as fixed-rate loans for a term not to exceed 15 years. Such loans are only made on owner-occupied one-to-four family residences and are subject to a 90% combined loan to value ratio. The underwriting standards for second mortgage loans are the same as the Bank s standards applicable to one-to-four family residential loans.

Business Lending. The Bank makes commercial business loans only on a secured or guaranteed basis. The terms of these loans generally do not exceed five years. These loans can have floating interest rates which adjust with changes in market interest rates, usually the prime rate, or have a fixed rate related to their term to maturity. The Bank s commercial business loans primarily consist of short-term loans for equipment, working capital, business expansion and inventory financing. The Bank customarily requires a personal guaranty of payment by the principals of any borrowing entity and reviews the financial statements and income tax returns of the guarantors. At December 31, 2006, the Bank had approximately $40 million outstanding in commercial business loans, which represented approximately 8% of its total loan portfolio. At December 31, 2006, the five largest commercial business loans totaled $14 million with no single loan larger than $4 million.

Loan Approval Authority and Underwriting. The Board of Directors of the Bank sets the authority to approve loans based on the amount, type of loan (i.e., secured or unsecured) and total exposure to the borrower. Where there are one or more existing loans to a borrower, the level of approval required is governed by the proposed total exposure including the new loan. The Board has approved loan authority and limits for certain of the Bank s lending personnel and senior officers, including the president of the Bank. Approval authority ranges from $5,000 to $750,000 for secured loans, and $5,000 to $100,000 for unsecured loans. Members of an in-house loan committee comprising four senior members of management approve all loans over $500,000. Any two members may combine their lending authority. The committee has the authority to approve secured loans up to $2.5 million and unsecured loans up to $200,000. All loans greater than $2.5 million through $5 million require the approval of a Board Loan Committee composed of four members of the Board of Directors of the Bank. All loans over $5 million or loans that cause the aggregate lending relationship to exceed $5 million must be approved by the Bank s Board of Directors.

One-to-four family residential mortgage loans are generally underwritten according to FHLMC and FNMA guidelines. For all loans originated by the Bank, upon receipt of a completed loan application from a prospective borrower, a credit report is ordered, income and certain other information is verified and, if necessary, additional financial information is requested. An appraisal of the real estate intended to secure the proposed loan is required

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which currently is performed by an independent appraiser designated and approved by the Bank. The Bank makes construction/permanent loans on individual properties. Funds advanced during the construction phase are held in a loan-in-process account and disbursed based upon various stages of completion. An independent appraiser or loan officer determines the stage of completion based upon a physical inspection of the construction and funds are advanced only for work in place. It is the Bank s policy to obtain title insurance or a title opinion on all real estate first mortgage loans in excess of $200,000. Borrowers must also obtain hazard or flood insurance (for loans on property located in a flood zone) prior to closing the loan. For loans in excess of 80% of the loan to value ratio, borrowers are generally required to advance funds on a monthly basis together with each payment of principal and interest to an escrow account from which the Bank makes disbursements for items such as real estate taxes and hazard insurance premiums. The Bank does not engage in sub-prime or no-doc style lending.

Loans to One Borrower. Current regulations limit loans to one borrower in an amount equal to 15% of unimpaired capital and retained income on an unsecured basis and an additional amount equal to 10% of unimpaired capital and retained income if the loan is secured by readily marketable collateral (generally, financial instruments, not real estate) or $500,000, whichever is higher. Penalties for violations of the loan-to-one borrower statutory and regulatory restrictions include cease and desist orders, the imposition of a supervisory agreement and civil money penalties. The Bank s maximum loan-to-one borrower limit was approximately $9.2 million as of December 31, 2006.

At December 31, 2006, the Bank s five largest aggregate lending relationships had balances ranging from $6.3 to $7.4 million. At December 31, 2006, all of these loans were current.

Mortgage-Backed Securities

To supplement lending activities, the Bank invests in residential mortgage-backed securities. Although the majority of such securities are held to maturity, they can serve as collateral for borrowings and, through repayments, as a source of liquidity.

The mortgage-backed securities portfolio as of December 31, 2006, consisted of pass-through certificates issued by the Federal Home Loan Mortgage Corporation (FHLMC) ($10.2 million), Government National Mortgage Association (GNMA), ($2.3 million) Federal National Mortgage Association (FNMA) ($13.4 million), and real estate mortgage investment conduits formed by these same agencies (REMICs) ($56.1 million).

At December 31, 2006, the amortized cost of mortgage-backed securities totaled $83.9 million, or 13% of total assets, and the market value of such securities totaled approximately $82.1 million.

The Bank s mortgage-backed securities are so-called pass-throughs which represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which are passed from the mortgage originators, through intermediaries (generally quasi-governmental agencies) that pool and repackage the participation interests in the form of securities, to investors such as the Bank. Such quasi-governmental agencies, which guarantee the payment of principal and interest to investors, primarily include FHLMC, FNMA and GNMA. The REMIC securities are composed of the same loan types as the pass through certificates, but offer differing characteristics as to their expected cash flows depending on the class of such securities purchased. The Bank s REMICs are primarily planned amortization classes and very accurately defined maturity classes that, when purchased, offered a high probability of predictable cash flows.

Mortgage-Backed Securities Carrying Value. The following table sets forth the carrying value of the Bank s mortgage-backed securities held in portfolio at the dates indicated.

	At December 31, 2006 (In thousands)	2005	2004
Held to maturity:			
GNMA-fixed rate	$ 2,316	$ 3,040	$ 4,516
FHLMC ARMs	40	44	65
FHLMC-fixed rate	2,257	3,117	5,130
FNMA-fixed rate	3,084	3,969	5,182
REMICs		7	7
Total mortgage-backed securities held to maturity	$ 7,697	$ 10,177	$ 14,900
Available-for-sale:			
FHLMC	$ 7,888	$ 9,686	$ 6,614
FNMA	10,330	12,173	15,108

REMICs	56,120	61,652	81,888
Total mortgage-backed securities available-for-sale	$ 74,338	$ 83,511	$ 103,610

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Mortgage-Backed Securities Maturity. The following table sets forth the maturity and the weighted average coupon (WAC) of the Bank s mortgage-backed securities portfolio at December 31, 2006. The table does not include estimated prepayments. Adjustable-rate mortgage-backed securities are shown as maturing based on contractual maturities.

	Contractual Held To Maturity Maturities Due (Dollars in thousands)	**WAC**		**Contractual Available -For-Sale Maturities Due**	**WAC**	
Less than 1 year	$ 144	7.16	%	$ 1,478	4.05	%
1 to 3 years	298	7.59		86	7.18	
3 to 5 years	153	6.81				
5 to 10 years	106	7.43		29,210	4.75	
10 to 20 years				24,219	4.63	
Over 20 years	6,996	6.20		19,345	4.42	
Total mortgage-backed securities	$ 7,697	6.30	%	$ 74,338	4.62	%

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Non-Performing and Problem Assets

Loan Collection. When a borrower fails to make a required payment on a loan, the Bank takes a number of steps to have the borrower cure the delinquency and restore the loan to current status. In the case of residential mortgage loans and consumer loans, the Bank generally sends the borrower a written notice of non-payment after the loan is 15 days past due. In the event payment is not then received, additional letters and phone calls are made. If the loan is still not brought current and it becomes necessary for the Bank to take legal action, which typically occurs after a loan is delinquent more than 90 days, the Bank will commence foreclosure proceedings against any real property that secures the loan and attempt to repossess any personal property that secures a consumer loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan generally is obtained by the Bank at foreclosure.

In the case of commercial real estate and multi-family loans, and construction loans, the Bank generally attempts to contact the borrower by telephone after any loan payment is ten days past due and a senior loan officer reviews all collection efforts made if payment is not received after the loan is 30 days past due. Decisions as to when to commence foreclosure actions for commercial real estate and multi-family loans and construction loans are made on a case by case basis. The Bank may consider loan work-out arrangements with these types of borrowers in certain circumstances.

On mortgage loans or loan participations purchased by the Bank, the Bank receives monthly reports from its loan servicers with which it monitors the loan portfolio. Based upon servicing agreements with the servicers of the loan, the Bank relies upon the servicer to contact delinquent borrowers, collect delinquent amounts and to initiate foreclosure proceedings, when necessary, all in accordance with applicable laws, regulations and the terms of the servicing agreements between the Bank and its servicing agents. At December 31, 2006 the Bank used third-party servicers to service $24.9 million in mortgage loans, including one servicer that serviced $17 million. Please see Item 3. Legal Proceedings for additional information regarding this servicer. All of the Bank s third-party mortgage loan servicers are regulated financial institutions or are approved by either HUD, FNMA, or FHLMC to service loans on their behalf.

Delinquent Loans. Generally, the Bank reserves for uncollected interest on loans past due more than 90 days; these loans are included in the table of nonaccrual loans below. Loans also are placed on a nonaccrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further collection. When a loan is placed on nonaccrual status, previously accrued but unpaid interest is deducted from interest income and the further accrual of interest ceases unless the underlying facts that prompted a nonaccrual determination are deemed to have improved significantly.

Non-Performing Assets. The following table sets forth information regarding non-accrual loans and real estate owned by the Bank at the dates indicated. The Bank had no loans contractually past due more than 90 days for which accrued interest has been recorded.

Non-performing assets

	At December 31, 2006	2005	2004	2003	2002
	(Dollars in thousands)				
Loans accounted for on a non-accrual basis:					
Mortgage loans:					
One-to-four family	$ 141	$ 392	$ 536	$ 1,549	$ 1,013
Commercial real estate and multi-family	61	877	23	296	1,677
Consumer and other	68	170	84	135	245
Commercial loans and leases	1,840	150	317	368	887
Total non-accrual loans	2,110	1,589	960	2,348	3,822
Real estate owned, net		700	700	868	84
Total non-performing assets	$ 2,110	$ 2,289	$ 1,660	$ 3,216	$ 3,906
Total non-accrual loans to loans	0.43 %	0.32 %	0.22 %	0.58 %	1.03 %
Total non-accrual loans to total assets	0.32 %	0.24 %	0.15 %	0.39 %	0.53 %
Total non-performing assets to total assets	0.32 %	0.35 %	0.26 %	0.53 %	0.54 %

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At December 31, 2006, the Bank had no foreign loans and no loan concentrations exceeding 10% of total loans not disclosed in above the table. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. Loans recorded in the category of other real estate owned are valued at the lower of book value of loans outstanding or fair market value less cost of disposal.

At December 31, 2006, the Bank was not aware of any potential problem loans that are not otherwise included in the foregoing table. Potential problem loans are loans where information about possible credit problems of borrowers has caused management to have serious doubts about the borrowers ability to comply with present repayment terms.

Classified Assets. OTS regulations provide for a classification system for problem assets of insured institutions which covers all problem assets. Under this classification system, problem assets of insured institutions are classified as substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that the establishment of a specific loss reserve is warranted. Assets designated special mention by management are assets included on the Bank s internal watchlist because of potential weakness but that do not currently warrant classification in one of the aforementioned categories.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances for loan losses in an amount deemed prudent by management. General allowances for OTS purposes represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. However, when an insured institution classifies all or a portion of a problem asset as loss, it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge off such amount. An institution s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS, which may order the establishment of additional general or specific loss allowances. A portion of general loss allowances established to cover possible losses related to assets classified as substandard or doubtful may be included in determining an institution s regulatory capital, while specific valuation allowances for loan losses generally do not qualify as regulatory capital.

The following table provides further information in regard to the Bank s classified assets as of December 31, 2006.

	At December 31, 2006 (In thousands)
Special mention assets	$ 36
Substandard	3,186
Doubtful assets	
Loss	
Total classified assets	$ 3,222

Real Estate Owned. Real estate acquired by the Bank as a result of foreclosure, judgment or by deed in lieu of foreclosure is classified as real estate owned (REO) until it is sold. When property is acquired it is recorded at the lower of fair value, minus estimated cost to sell, or cost. If the property subsequently decreases in estimated value from the initial recorded amount, the Bank will provide a valuation allowance, through a charge to earnings, if the decrease is judged by management to be temporary. If the decrease is judged to be permanent, the Bank will reduce the recorded amount, through a charge to earnings, to the new estimated value.

Allowances for Loan Losses. The Bank provides valuation allowances for estimated losses from uncollectible loans. Management determines the adequacy of the allowance on a quarterly basis to ensure that a provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is appropriate based upon management s estimate of probable losses. Several sources of data are used in making the evaluation as to the appropriateness of the allowance.

In establishing reserves, a specific reserve is established for loans which because of past payment history, a review of recent financial information, or other facts regarding the credit, pose a higher than normal amount of perceived risk of collection. In addition, a reserve is assigned based upon qualitative and quantitative risk factors which are inherent in segments of the loan portfolio.

Although the allowance has been allocated to determine the appropriateness of the reserve, the total allowance is available to absorb any and all losses from any segment of the loan portfolio. At December 31, 2006, management believes that the allowance for loan loss is at an acceptable level.

The following table sets forth information with respect to the Bank s allowance for loan losses at the dates and for the periods indicated:

	For the Years Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(Dollars in thousands)				
Balance at beginning of period	$ 2,641	$ 2,307	$ 2,111	$ 2,047	$ 1,972
Provision for loan losses	150	540	600	330	988
Charge-offs:					
One-to-four family				(16)	(13)
Commercial and multi-family real estate loans			(112)		
Consumer and other loans	(55)	(122)	(186)	(219)	(303)
Commercial loans and leases	(1)	(286)	(161)	(322)	(625)
Recoveries:					
One-to-four family					3
Consumer and other loans	65	39	55	36	25
Commercial loans and leases	65	163		255	
Balance at end of year	$ 2,865	$ 2,641	$ 2,307	$ 2,111	$ 2,047
Ratio of net charge-offs during the period to average loans outstanding during the period	(0.01)%	0.04 %	0.09 %	0.07 %	0.25 %
Ratio of allowance for loan losses to non-performing loans at the end of the period	135.8 %	166.3 %	240.3 %	89.9 %	53.6 %
Ratio of allowance for loan losses to loans receivable at the end of the period	0.59 %	0.54 %	0.52 %	0.52 %	0.55 %
Ratio of allowance for loan losses and foreclosed real estate to total non-performing assets at the end of the period	135.8 %	115.4 %	139.0 %	65.6 %	52.4 %

The following table sets forth the allocation of the Bank s allowance for loan losses by loan category and the percent of loans in each category to total loans receivable, gross, at the dates indicated.

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	At December 31, 2006 Amount	Percent of Loans to Total Loans		2005 Amount	Percent of Loans to Total Loans		2004 Amount	Percent of Loans to Total Loans		2003 Amount	Percent of Loans to Total Loans		2002 Amount	Percent of Loans to Total Loans	
	(Dollars in thousands)														
At end of period allocated to:															
One-to-four family	$ 332	54.9	%	$ 154	58.8	%	$ 176	64.1	%	$ 277	68.2	%	$ 119	61.3	%
Commercial real estate and multi-family	665	19.3		1,010	18.2		1,035	18.8		1,230	18.3		1,021	23.0	
Construction	621	7.2		738	5.0		121	2.3		109	1.6		90	3.2	
Consumer and other loans	248	10.3		115	8.2		554	7.7		246	7.8		271	9.7	
Commercial loans and leases	999	8.3		624	9.8		421	7.1		249	4.1		546	2.8	
Total allowance	$ 2,865	100.0	%	$ 2,641	100.0	%	$ 2,307	100.0	%	$ 2,111	100.0	%	$ 2,047	100.0	%

Investment Activities

The investment policy of the Bank, which is established by the Board of Directors and implemented by the Asset Liability Committee, is designed primarily to provide and maintain liquidity, to generate a favorable return on investments without incurring undue interest rate and credit risk, and to complement the Bank s lending activities. In establishing its investment strategies, the Bank considers its business and growth plans, the economic environment, the types of securities to be held and other factors. Federally chartered savings institutions have the authority to invest in various types of assets, including U.S. Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, certain bankers acceptances, repurchase agreements, loans on federal funds, and, subject to certain limits, commercial paper and mutual funds.

The following table sets forth certain information regarding the amortized cost and fair values of the Bank s investments at the dates indicated.

	At December 31, 2006 Amortized Cost	Fair Value	2005 Amortized Cost	Fair Value	2004 Amortized Cost	Fair Value
	(In thousands)					
Interest-earning deposits	$ 6,860	$ 6,860	$ 177	$ 177	$ 252	$ 252
Investment securities held-to-maturity:						
State and political subdivisions	$ 677	$ 681	$ 1,015	$ 1,036	$ 1,326	$ 1,395
Corporate debt securities			3,675	3,671	5,701	5,793
Total	$ 677	$ 681	$ 4,690	$ 4,707	$ 7,027	$ 7,188
Securities available-for-sale:						
U.S. government and agency obligations	$ 5,990	$ 5,911	$ 5,982	$ 5,880	$ 2,978	$ 2,958
State and political subdivisions	24,406	24,429	20,844	20,563	13,704	13,675
Corporate debt securities	4,003					