

TF FINANCIAL CORP  
Form 10-K  
March 30, 2009

**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**



x

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

**For the fiscal year ended December 31, 2008**



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)



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**Delaware**

(State or Other Jurisdiction of Incorporation  
or Organization)

**74-2705050**

(I.R.S. Employer Identification No.)

**3 Penns Trail, Newtown, Pennsylvania**

(Address of Principal Executive Offices)

**18940**

(Zip Code)

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

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

**Title of each class**  
Common Stock, par value \$.10 per share

**Name of each exchange on which registered**  
The Nasdaq Stock Market LLC

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

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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, 2008, was \$41.2 million (1,917,272 shares at \$21.51 per share).

As of March 09, 2009 there were outstanding 2,662,871 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, 2008. (Parts I, II and IV)
  2. Portions of the Proxy Statement for the 2009 Annual Meeting of Stockholders. (Part III)
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**PART I**



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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**

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On July 13, 1994, the Company consummated its public offering of 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, 2008, the Company had total assets of \$733.7 million, total liabilities of \$666.0 million and stockholders' equity of \$67.7 million.

### **BUSINESS OF THE BANK**

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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, 2008 the Bank operated fourteen 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, 2008, one-to-four family

residential mortgage loans totaled \$283.5 million or 52% of the Bank's total loan portfolio. At that same date, the Bank had approximately \$112.0 million or 15% of total assets invested in mortgage-backed securities and \$31.6 million or 4% 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 Commonwealth of Pennsylvania to conduct business as an insurance agency.

**Market Area**





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The Bank offers a wide range of consumer and business products at its fourteen 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 two branches are in Mercer County, New Jersey which has an expanding population and represents another growth area for the Bank.

### **Competition**



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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, 2008 the Company's share of deposits in each of the counties in which it operates was as follows:

| <b>County, State</b>       | <b>Market Share for<br/>Entire County</b> | <b>Market Share for ZIP Codes<br/>Including Company Branches</b> |
|----------------------------|---|--|
| Philadelphia, Pennsylvania | 0.48%                                     | 11.09%   |
| Bucks, Pennsylvania        | 1.56%                                     | 5.71%  |
| Mercer, New Jersey         | 0.42%                                     | 7.54%  |

### **Lending Activities**



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**General.** The Bank's loan portfolio composition consists primarily of 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, 2008, the Bank's mortgage loans outstanding were \$446.8 million, of which \$283.5 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, 24% were ARM s and 76% were fixed-rate loans. At that same date, commercial real estate and multi-family residential loans totaled \$132.6 million, and construction loans totaled \$30.6 million. The construction loans are predominately floating-rate, prime-rate-based loans.

Consumer and other loans held by the Bank totaled \$58.5 million or 11% of total loans outstanding at December 31, 2008, of which \$56.2 million consisted of home equity and second mortgage loans. At that same date commercial business loans totaled \$43.8 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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|  | 2008       |                  | 2007       |                  | At December 31,<br>2006 |                  | 2005       |                  | 2004       |                  |
|--|------------|------------------|------------|------------------|-------------------------|------------------|------------|------------------|------------|------------------|
|  | Amount     | Percent of Total | Amount     | Percent of Total | Amount                  | Percent of Total | Amount     | Percent of Total | Amount     | Percent of Total |
| (Dollars in thousands)                                   |            |                  |            |                  |                         |                  |            |                  |            |                  |
| <b>Loans held for investment:</b>                        |            |                  |            |                  |                         |                  |            |                  |            |                  |
| Mortgage loans:  |            |                  |            |                  |                         |                  |            |                  |            |                  |
| One-to-four family                                       | \$ 281,870 | 51.48%           | \$ 272,840 | 52.55%           | \$ 266,789              | 54.91%           | \$ 289,678 | 58.76%           | \$ 283,965 | 64.08%           |
| Commercial real estate and multi-family                  | 132,640    | 24.23            | 109,740    | 21.14            | 93,607                  | 19.26            | 89,489     | 18.15            | 83,559     | 18.86            |
| Construction   | 30,633     | 5.60             | 35,507     | 6.84             | 34,944                  | 7.19             | 24,888     | 5.04             | 10,286     | 2.32             |
| Total mortgage loans                                     | 445,143    | 81.31            | 418,087    | 80.53            | 395,340                 | 81.36            | 404,055    | 81.95            | 377,810    | 85.26            |
| Consumer loans:  |            |                  |            |                  |                         |                  |            |                  |            |                  |
| Home equity and second mortgage                          | 56,233     | 10.27            | 52,013     | 10.02            | 46,864                  | 9.65             | 37,479     | 7.60             | 29,522     | 6.66             |
| Other consumer   | 2,287      | 0.42             | 2,244      | 0.43             | 3,206                   | 0.66             | 2,836      | 0.58             | 4,384      | 0.99             |
| Total consumer and other loans                           | 58,520     | 10.69            | 54,257     | 10.45            | 50,070                  | 10.31            | 40,315     | 8.18             | 33,906     | 7.65             |
| Commercial loans and leases:                             |            |                  |            |                  |                         |                  |            |                  |            |                  |
| Commercial loans   | 43,818     | 8.00             | 46,850     | 9.02             | 40,458                  | 8.33             | 48,471     | 9.83             | 30,543     | 6.90             |
| Commercial leases  |            |                  |            |                  | 36                      |                  | 186        | 0.04             | 857        | 0.19             |
| Total commercial loans and leases                        | 43,818     | 8.00             | 46,850     | 9.02             | 40,494                  | 8.33             | 48,657     | 9.87             | 31,400     | 7.09             |
| Total loans  | 547,481    | 100.00%          | 519,194    | 100.00%          | 485,904                 | 100.00%          | 493,027    | 100.00%          | 443,116    | 100.00%          |
| Net of:  |            |                  |            |                  |                         |                  |            |                  |            |                  |
| Deferred loan origination costs and unamortized premiums | 704        |                  | 675        |                  | 531                     |                  | 505        |                  | 706        |                  |
| Allowance for loan losses                                | (3,855)    |                  | (2,842)    |                  | (2,865)                 |                  | (2,641)    |                  | (2,307)    |                  |
|  | \$ 544,330 |                  | \$ 517,027 |                  | \$ 483,570              |                  | \$ 490,891 |                  | \$ 441,515 |                  |

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|                                       |    |       |         |    |       |         |    |     |         |    |    |         |    |     |         |
|---------------------------------------|----|-------|---------|----|-------|---------|----|-----|---------|----|----|---------|----|-----|---------|
| Total loans, held for investment, net |    |       |         |    |       |         |    |     |         |    |    |         |    |     |         |
| <b>Loans held for sale:</b>           |    |       |         |    |       |         |    |     |         |    |    |         |    |     |         |
| Mortgage loans:                       |    |       |         |    |       |         |    |     |         |    |    |         |    |     |         |
| One-to-four family                    | \$ | 1,659 | 100.00% | \$ | 1,040 | 100.00% | \$ | 969 | 100.00% | \$ | 68 | 100.00% | \$ | 680 | 100.00% |
| Total loans held for sale             | \$ | 1,659 | 100.00% | \$ | 1,040 | 100.00% | \$ | 969 | 100.00% | \$ | 68 | 100.00% | \$ | 680 | 100.00% |

|   |    |       |         |    |       |         |    |       |         |    |        |         |    |        |         |
|---|----|-------|---------|----|-------|---------|----|-------|---------|----|--------|---------|----|--------|---------|
| <b>Mortgage-backed securities held-to-maturity:</b>           |    |       |         |    |       |         |    |       |         |    |        |         |    |        |         |
| FHLMC   | \$ | 1,100 | 23.04%  | \$ | 1,657 | 26.90%  | \$ | 2,297 | 29.84%  | \$ | 3,161  | 31.06%  | \$ | 5,195  | 34.87%  |
| FNMA  |    | 2,141 | 44.85   |    | 2,634 | 42.76   |    | 3,084 | 40.07   |    | 3,969  | 39.00   |    | 5,182  | 34.77   |
| GNMA  |    | 1,533 | 32.11   |    | 1,869 | 30.34   |    | 2,316 | 30.09   |    | 3,040  | 29.87   |    | 4,516  | 30.31   |
| Real estate investment mortgage conduit                       |    |       |         |    |       |         |    |       |         |    | 7      | 0.07    |    | 7      | 0.05    |
| Total mortgage-backed and related securities held-to-maturity | \$ | 4,774 | 100.00% | \$ | 6,160 | 100.00% | \$ | 7,697 | 100.00% | \$ | 10,177 | 100.00% | \$ | 14,900 | 100.00% |

|   |    |         |         |    |        |         |    |        |         |    |        |         |    |         |         |
|---|----|---------|---------|----|--------|---------|----|--------|---------|----|--------|---------|----|---------|---------|
| <b>Mortgage-backed securities available-for-sale:</b>           |    |         |         |    |        |         |    |        |         |    |        |         |    |         |         |
| FHLMC   | \$ | 4,504   | 4.20%   | \$ | 5,434  | 5.54%   | \$ | 7,888  | 10.61%  | \$ | 9,686  | 11.60%  | \$ | 6,614   | 6.38%   |
| FNMA  |    | 12,320  | 11.49   |    | 11,183 | 11.39   |    | 10,330 | 13.90   |    | 12,173 | 14.58   |    | 15,108  | 14.58   |
| Real estate investment mortgage conduit                         |    | 90,393  | 84.31   |    | 81,561 | 83.07   |    | 56,120 | 75.49   |    | 61,652 | 73.82   |    | 81,888  | 79.04   |
| Total mortgage-backed and related securities available-for-sale | \$ | 107,217 | 100.00% | \$ | 98,178 | 100.00% | \$ | 74,338 | 100.00% | \$ | 83,511 | 100.00% | \$ | 103,610 | 100.00% |

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**Loan Maturity and Repricing Information.** The following table sets forth certain information at December 31, 2008, 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, 2008, are reported as due in one year or less. The table does not include prepayments or scheduled principal repayments.

|   | Due 1/1/09 -<br>12/31/09 | Due 1/1/10 -<br>12/31/13<br>(In thousands) | Due After<br>12/31/13 |
|---|--------------------------|--|-----------------------|
| <b>Available for sale:</b>              |                          |  |                       |
| Mortgage-backed securities              | \$ 2                     | \$ 6,575                                   | \$ 100,640            |
| Loans receivable                        |                          |  | 1,659                 |
| Total                                   | \$ 2                     | \$ 6,575                                   | \$ 102,299            |
| <b>Held to Maturity:</b>                |                          |  |                       |
| One-to-four family                      | \$ 138                   | \$ 6,298                                   | \$ 275,434            |
| Commercial real estate and multi-family | 5,223                    | 5,407                                      | 122,010               |
| Construction                            | 30,633                   |  |                       |
| Consumer and other                      | 176                      | 4,789                                      | 53,555                |
| Commercial loans                        | 28,980                   | 7,074                                      | 7,764                 |
| Total loans receivable                  | 65,150                   | 23,568                                     | 458,763               |
| Mortgage-backed securities              | 18                       | 94   | 4,662                 |
| Total                                   | \$ 65,168                | \$ 23,662                                  | \$ 463,425            |

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The following table sets forth the dollar amount of all loans and mortgage-backed securities due after December 31, 2009, 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<br>Rates | (In thousands)                 |                   |
|---|------------------------|--------------------------------|-------------------|
|   |                        | Floating or<br>Adjustable Rate |                   |
| <b>Available for sale:</b>              |                        |                                |                   |
| Mortgage-backed securities              | \$                     | 107,215                        | \$                |
| Loans                                   |                        | 1,659                          |                   |
| <b>Total</b>                            | <b>\$</b>              | <b>108,874</b>                 | <b>\$</b>         |
| <b>Held to Maturity:</b>                |                        |                                |                   |
| One-to-four family                      | \$                     | 229,331                        | \$ 52,401         |
| Commercial real estate and multi-family |                        | 3,019                          | 124,398           |
| <b>Construction</b>                     |                        |                                |                   |
| Consumer and other                      |                        | 36,107                         | 22,237            |
| Commercial loans and leases             |                        | 8,006                          | 6,832             |
| <b>Total loans receivable</b>           |                        | <b>276,463</b>                 | <b>205,868</b>    |
| Mortgage-backed securities              |                        | 4,737                          | 19                |
| <b>Total</b>                            | <b>\$</b>              | <b>281,200</b>                 | <b>\$ 205,887</b> |

**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 through the Bank's retail banking channels, 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 also 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. The mortgage loan officers support the Bank's branches and customers, and additionally engage in calling efforts directed toward realtors, builders, other loan originators and others that can be sources of lending business for the Bank.

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 or FNMA while retaining the servicing rights on these loans. As of December 31, 2008, the Bank's portfolio of loans serviced for FHLMC or FNMA totaled approximately \$49.3 million. The Bank also brokers a small portion of its loan closings to correspondents on a servicing released basis. However, the Bank is primarily a portfolio lender.

**Commercial Real Estate and Multi-Family Lending.** The Bank originates permanent loans secured by commercial real estate including non-owner occupied residential, multi-family dwelling units, professional office buildings and hotels/motels. 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 and typically 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, 2008, the five largest commercial real estate and multi-family loans totaled \$27.2 million with no single loan larger than \$7.5 million. At December 31, 2008, all such loans were current and the properties securing such loans are in the Bank's market area.

**Construction and Land Acquisition Lending.** At December 31, 2008, the Bank's construction and land acquisition loans were \$30.6 million or 6% 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. Land acquisition lending is susceptible to the risks of obtaining necessary approvals and permits, and the feasibility of the project once such approvals are obtained. At December 31, 2008, the five largest construction land acquisition loans totaled \$17.9 million with no single loan larger than \$5.8 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 \$58.5 million or 11% of the Bank's total loan portfolio at December 31, 2008. The Bank originates consumer loans through its retail banking channel and mortgage loan department.

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 evaluated. 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 can have a higher risk of default than residential mortgage loans. However, at December 31, 2008, \$126,000 or 0.2% of the Bank's consumer loans were delinquent more than 90 days, compared to \$780,000 or 0.02% of residential one-to-four family loans.

The Bank offers second mortgage loans on one-to-four family residences. At December 31, 2008, second mortgage and home equity loans totaled \$56.2 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 or prime-rate-based floating rate loans with amortization periods up to 15 years and in some cases, an interest-only period of up to the first 60 months of the loan term. 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 predominantly 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, and typically have some real estate collateral. 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, 2008, the Bank had approximately \$43.8 million outstanding in commercial business loans, which represented approximately 8% of its total loan portfolio. At December 31, 2008, the five largest commercial business loans totaled \$19.7 million with no single loan larger than \$5.2 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 \$75,000 to \$750,000 for secured loans, and \$25,000 to \$100,000 for unsecured loans. Members of an in-house loan committee comprising four senior members of management can approve in certain combinations all loans over \$750,000 up to \$2.0 million. The committee has the authority to approve secured loans up to \$2.0 million and unsecured loans up to \$200,000. All loans greater than \$2.0 million through \$5.0 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 \$5.0 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. The Bank does not engage in sub-prime, stated income or no-doc style portfolio lending. An appraisal of the real estate intended to secure the proposed loan is required and is performed by an

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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 \$500,000. 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.

**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 \$9.7 million as of December 31, 2008.

At December 31, 2008, the Bank's five largest aggregate lending relationships pursuant to the loans to one borrower regulations had balances ranging from \$6.6 to \$8.6 million. At December 31, 2008, 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, 2008, consisted of pass-through certificates issued by the Federal Home Loan Mortgage Corporation (FHLMC) (\$5.6 million), Government National Mortgage Association (GNMA), (\$1.5 million), Federal National Mortgage Association (FNMA) (\$14.5 million), real estate mortgage investment conduits (REMICs) formed from pass-through certificates issued by these same agencies (\$87.1 million), and issued by private issuers (\$3.3 million).

At December 31, 2008, the amortized cost of mortgage-backed securities totaled \$110.6 million, or 15% of total assets, and the fair value of such securities totaled approximately \$112.2 million.

The Bank's mortgage-backed securities which are so-called "pass-through" represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which are passed through intermediaries (generally quasi-governmental agencies) to investors such as the Bank. Such quasi-governmental agencies, which guarantee the payment of principal and interest to investors, 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 (PAC) and very accurately defined maturity (VADM) 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.

|   | 2008       | At December 31,<br>2007 |    | 2006   |
|---|------------|-------------------------|----|--------|
|   |            | (In thousands)          |    |        |
| <b>Held to maturity:</b>                            |            |                         |    |        |
| GNMA-fixed rate                                     | \$ 1,533   | \$ 1,869                | \$ | 2,316  |
| FHLMC ARMs  | 19         | 27                      |    | 40     |
| FHLMC-fixed rate                                    | 1,081      | 1,630                   |    | 2,257  |
| FNMA-fixed rate                                     | 2,141      | 2,634                   |    | 3,084  |
| Total mortgage-backed securities held to maturity   | \$ 4,774   | \$ 6,160                | \$ | 7,697  |
| <b>Available-for-sale:</b>                          |            |                         |    |        |
| FHLMC   | \$ 4,504   | \$ 5,434                | \$ | 7,888  |
| FNMA  | 12,320     | 11,183                  |    | 10,330 |
| REMICs  | 90,393     | 81,561                  |    | 56,120 |
| Total mortgage-backed securities available-for-sale | \$ 107,217 | \$ 98,178               | \$ | 74,338 |



**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, 2008. The table does not include estimated prepayments. Adjustable-rate mortgage-backed securities are shown as maturing based on contractual maturities.

|                                  | Contractual Held<br>To Maturity<br>Maturities Due | WAC                    | Contractual<br>Available<br>-For-Sale<br>Maturities Due | WAC   |
|----------------------------------|---|------------------------|---|-------|
|                                  |   | (Dollars in thousands) |   |       |
| Less than 1 year                 | \$ 18   | 7.89%                  | \$ 2  | 7.41% |
| 1 to 3 years                     | 59  | 6.79                   |   |       |
| 3 to 5 years                     | 34  | 7.96                   | 6,575   | 4.78  |
| 5 to 10 years                    | 757   | 5.03                   | 40,993  | 4.67  |
| 10 to 20 years                   | 2,457   | 6.77                   | 32,444  | 4.75  |
| Over 20 years                    | 1,449   | 5.62                   | 27,203  | 4.76  |
| Total mortgage-backed securities | \$ 4,774  | 6.15%                  | \$ 107,217  | 4.72% |

**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 and serviced by others, 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, 2008 the Bank used third-party servicers to service \$7.2 million in mortgage loans. 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**

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|   | 2008     | 2007     | At December 31,<br>2006 |          | 2005     | 2004 |
|---|----------|----------|-------------------------|----------|----------|------|
|   |          |          | (Dollars in thousands)  |          |          |      |
| Loans accounted for on a non-accrual basis: |          |          |                         |          |          |      |
| Mortgage loans:                             |          |          |                         |          |          |      |
| One-to-four family                          | \$ 780   | \$ 165   | \$ 141                  | \$ 392   | \$ 536   |      |
| Commercial real estate and multi-family     | 606      | 39       | 61                      | 877      | 23       |      |
| Construction                                | 3,017    | 3,280    |                         |          |          |      |
| Consumer and other                          | 126      | 34       | 68                      | 170      | 84       |      |
| Commercial loans and leases                 | 750      | 1,840    | 1,840                   | 150      | 317      |      |
| Total non-accrual loans                     | 5,279    | 5,358    | 2,110                   | 1,589    | 960      |      |
| Real estate owned, net                      |          |          |                         | 700      | 700      |      |
| Total non-performing assets                 | \$ 5,279 | \$ 5,358 | \$ 2,110                | \$ 2,289 | \$ 1,660 |      |
| Total non-accrual loans to loans            | 0.96%    | 1.03%    | 0.43%                   | 0.32%    | 0.22%    |      |
| Total non-accrual loans to total assets     | 0.72%    | 0.76%    | 0.32%                   | 0.24%    | 0.15%    |      |
| Total non-performing assets to total assets | 0.72%    | 0.76%    | 0.32%                   | 0.35%    | 0.26%    |      |

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At December 31, 2008, 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.

At December 31, 2008, 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 may be 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 determine that general or specific allowances are insufficient. 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, 2008.

| <b>At December 31, 2008</b>    |                  |
|--------------------------------|------------------|
| <b>(In thousands)</b>          |                  |
| Special mention assets         | \$ 9,743         |
| Substandard                    | 16,534           |
| Doubtful assets                |                  |
| Loss                           |                  |
| <b>Total classified assets</b> | <b>\$ 26,277</b> |

**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, 2008, 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, |       |      |       |      |         |      |        |      |        |
|--|----------------------------------|-------|------|-------|------|---------|------|--------|------|--------|
|  | 2008                             |       | 2007 |       | 2006 |         | 2005 |        | 2004 |        |
|  | (Dollars in thousands)           |       |      |       |      |         |      |        |      |        |
| Balance at beginning of period   | \$                               | 2,842 | \$   | 2,865 | \$   | 2,641   | \$   | 2,307  | \$   | 2,111  |
| Provision for loan losses  |                                  | 1,500 |      |       |      | 150     |      | 540    |      | 600    |
| Charge-offs:   |                                  |       |      |       |      |         |      |        |      |        |
| One-to-four family   |                                  | (12)  |      | (27)  |      |         |      |        |      |        |
| Commercial and multi-family real estate loans  |                                  |       |      |       |      |         |      |        |      | (112)  |
| Construction   |                                  | (347) |      |       |      |         |      |        |      |        |
| Consumer and other loans   |                                  | (55)  |      | (69)  |      | (55)    |      | (122)  |      | (186)  |
| Commercial loans and leases  |                                  | (160) |      | (1)   |      | (1)     |      | (286)  |      | (161)  |
| Recoveries:  |                                  |       |      |       |      |         |      |        |      |        |
| Consumer and other loans   |                                  | 19    |      | 13    |      | 65      |      | 39     |      | 55     |
| Commercial loans and leases  |                                  | 68    |      | 61    |      | 65      |      | 163    |      |        |
| Balance at end of year   | \$                               | 3,855 | \$   | 2,842 | \$   | 2,865   | \$   | 2,641  | \$   | 2,307  |
| Ratio of net charge-offs (net recoveries) during the period to average loans outstanding during the period |                                  | 0.09% |      | 0.02% |      | (0.01)% |      | 0.04%  |      | 0.09%  |
| Ratio of allowance for loan losses to non-performing loans at the end of the period                        |                                  | 73.0% |      | 53.0% |      | 135.8%  |      | 166.3% |      | 240.3% |
|  |                                  | 0.71% |      | 0.55% |      | 0.59%   |      | 0.54%  |      | 0.52%  |

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|   |  |       |  |       |  |        |  |        |  |        |
|---|--|-------|--|-------|--|--------|--|--------|--|--------|
| Ratio of allowance for loan losses to loans receivable at the end of the period                                       |  |       |  |       |  |        |  |        |  |        |
| Ratio of allowance for loan losses and foreclosed real estate to total non-performing assets at the end of the period |  | 73.0% |  | 53.0% |  | 135.8% |  | 115.4% |  | 139.0% |

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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.

|   | 2008     |                                       | 2007     |                                       | At December 31,<br>2006 |                                       | 2005     |                                       | 2004     |                                       |
|---|----------|---------------------------------------|----------|---------------------------------------|-------------------------|---------------------------------------|----------|---------------------------------------|----------|---------------------------------------|
|   | Amount   | Percent of<br>Loans to<br>Total Loans | Amount   | Percent of<br>Loans to<br>Total Loans | Amount                  | Percent of<br>Loans to<br>Total Loans | Amount   | Percent of<br>Loans to<br>Total Loans | Amount   | Percent of<br>Loans to<br>Total Loans |
| (Dollars in thousands)                  |          |                                       |          |                                       |                         |                                       |          |                                       |          |                                       |
| At end of period allocated to:          |          |                                       |          |                                       |                         |                                       |          |                                       |          |                                       |
| One-to-four family                      | \$ 1,461 | 37.9%                                 | \$ 504   | 17.8%                                 | \$ 332                  | 54.9%                                 | \$ 154   | 58.8%                                 | \$ 176   | 64.1%                                 |
| Commercial real estate and multi-family | 845      | 21.9                                  | 667      | 23.5                                  | 665                     | 19.3                                  | 1,010    | 18.2                                  | 1,035    | 18.8                                  |
| Construction                            | 953      | 24.7                                  | 1,018    | 35.8                                  | 621                     | 7.2                                   | 738      | 5.0                                   | 121      | 2.3                                   |
| Consumer and other loans                | 259      | 6.7                                   | 246      | 8.6                                   | 248                     | 10.3                                  | 115      | 8.2                                   | 554      | 7.7                                   |
| Commercial loans and leases             | 337      | 8.8                                   | 407      | 14.3                                  | 999                     | 8.3                                   | 624      | 9.8                                   | 421      | 7.1                                   |
| Total allowance                         | \$ 3,855 | 100.0%                                | \$ 2,842 | 100.0%                                | \$ 2,865                | 100.0%                                | \$ 2,641 | 100.0%                                | \$ 2,307 | 100.0%                                |

**Investment Securities**





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The purchase of investment securities 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 investment securities at the dates indicated.

|   | 2008              |               | At December 31,<br>2007 |               | 2006              |               |
|---|-------------------|---------------|-------------------------|---------------|-------------------|---------------|
|   | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost       | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
| Interest-earning deposits               | \$ 56             | \$ 56         | \$ 123                  | \$ 123        | \$ 6,860          | \$ 6,860      |
| Investment securities held-to-maturity: |                   |               |                         |               |                   |               |
| State and political subdivisions        | \$                | \$            | \$ 244                  | \$ 246        | \$ 677            | \$ 681        |
| Total                                   | \$                | \$            | \$ 244                  | \$ 246        | \$ 677            | \$ 681        |
| Securities available-for-sale:          |                   |               |                         |               |                   |               |
| U.S. government and agency obligations  | \$ 2,944          | \$ 3,173      | \$ 2,996                | \$ 2,982      | \$ 5,990          | \$ 5,911      |
| State and political subdivisions        | 24,532            | 24,996        | 24,628                  | 24,833        | 24,406            | 24,429        |
| Corporate debt securities               | 3,340             | 3,285         | 4,340                   | 4,377         | 4,003             | 3,982         |
| Equities                                | 150               | 165           | 150                     | 171           | 150               | 202           |
| Total                                   | \$ 30,966         | \$ 31,619     | \$ 32,114               | \$ 32,363     | \$ 34,549         | \$ 34,524     |

### Investment Portfolio Maturities



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The following table sets forth certain information regarding the amortized cost, weighted average yields and maturities of the Bank's investment securities portfolio, exclusive of interest-earning deposits, at December 31, 2008. Yields on tax exempt obligations have been computed on a tax equivalent basis.

|  | One Year or Less |               | One to Five Years |               | Five to Ten Years |               | More than Ten Years |               | Total Investment Securities(1) |               |                  |     |
|--|------------------|---------------|-------------------|---------------|-------------------|---------------|---------------------|---------------|--------------------------------|---------------|------------------|-----|
|  | Amortized Cost   | Average Yield | Amortized Cost    | Average Yield | Amortized Cost    | Average Yield | Amortized Cost      | Average Yield | Amortized Cost                 | Average Yield | Fair Value       |     |
| (Dollars in thousands)                 |                  |               |                   |               |                   |               |                     |               |                                |               |                  |     |
| Equities                               | \$ 150           |               | % \$              |               | % \$              |               | % \$                |               | % \$                           | 150           | % \$             | 165 |
| U.S. government and agency obligations |                  |               | 2,944             | 4.18          |                   |               |                     |               | 2,944                          | 4.18          | 3,173            |     |
| State and political subdivisions       |                  |               | 3,005             | 3.30          | 16,209            | 3.63          | 5,318               | 4.18          | 24,532                         | 3.71          | 24,996           |     |
| Corporate debt securities              |                  |               | 3,340             | 5.50          |                   |               |                     |               | 3,340                          | 5.50          | 3,285            |     |
| <b>Total</b>                           | <b>\$ 150</b>    |               | <b>% \$ 9,289</b> | <b>4.37%</b>  | <b>\$ 16,209</b>  | <b>3.63%</b>  | <b>\$ 5,318</b>     | <b>4.18%</b>  | <b>\$ 30,966</b>               | <b>3.93%</b>  | <b>\$ 31,619</b> |     |

### Sources of Funds

**General.** Deposits, borrowings, loan repayments and cash flows generated from operations are the primary sources of the Bank's funds for use in lending, investing and other general purposes.

**Deposits.** The Bank offers a variety of deposit accounts having a range of interest rates and terms. The Bank's deposits consist of regular savings, non-interest bearing checking, NOW checking, money market, and certificate accounts. Of the deposit accounts, \$36.4 million or 7% consist of IRA, Keogh or SEP retirement accounts at December 31, 2008.

The flow of deposits is influenced significantly by general economic conditions, changes in money market and prevailing interest rates and competition. The Bank's deposits are primarily obtained from areas surrounding its offices, and the Bank relies primarily on customer service and long-standing relationships with customers to attract and retain these deposits. The Bank has historically maintained a high level of core deposits consisting of regular savings, money market, non-interest-bearing checking, and NOW checking, which has contributed to a low cost-of-funds. At December 31, 2008, core deposits amounted to 58% of total deposits.

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The following table sets forth the distribution of the Bank's deposit accounts at the dates indicated and the weighted average nominal interest rates on each category of deposits presented. The Bank does not have significant amount of deposits from outside its market area. Management does not believe that the use of year end balances instead of average balances resulted in any material difference in the information presented.

|  | 2008       |                           | At December 31,<br>2007       |            |                           | 2006                          |            |                           |                               |
|--|------------|---------------------------|-------------------------------|------------|---------------------------|-------------------------------|------------|---------------------------|-------------------------------|
|  | Amount     | Percent of Total Deposits | Weighted Average Nominal Rate | Amount     | Percent of Total Deposits | Weighted Average Nominal Rate | Amount     | Percent of Total Deposits | Weighted Average Nominal Rate |
| (Dollars in thousands)                 |            |                           |                               |            |                           |                               |            |                           |                               |
| <b>Transaction Accounts</b>            |            |                           |                               |            |                           |                               |            |                           |                               |
| Interest-bearing checking accounts     | \$ 46,907  | 9.58                      | 0.45%                         | \$ 46,543  | 9.85                      | 0.48%                         | \$ 51,272  | 10.72%                    | 0.48%                         |
| Money market accounts                  | 88,609     | 18.09                     | 2.15                          | 79,267     | 16.78                     | 3.69                          | 62,914     | 13.16                     | 3.21                          |
| Non-interest-bearing checking accounts | 36,871     | 7.53                      |                               | 35,904     | 7.60                      |                               | 36,991     | 7.74                      |                               |
| Total transaction accounts             | 172,387    | 35.20                     |                               | 161,714    | 34.23                     |                               | 151,177    | 31.62                     |                               |
| Passbook accounts                      | 111,591    | 22.77                     | 1.12                          | 130,423    | 27.61                     | 1.79                          | 131,359    | 27.48                     | 2.21                          |
| Certificates of deposit                | 205,872    | 42.03                     | 3.58                          | 180,257    | 38.16                     | 4.50                          | 195,551    | 40.90                     | 4.35                          |
| Total deposits                         | \$ 489,850 | 100.00%                   | 2.19%                         | \$ 472,394 | 100.00%                   | 2.88%                         | \$ 478,087 | 100.00%                   | 2.86%                         |

At December 31, 2008, the Bank had outstanding certificates of deposit in amounts of \$100,000 or more maturing as follows:

| Maturing Period               | Amount<br>(In thousands) |
|-------------------------------|--------------------------|
| Three months or less          | \$ 14,016                |
| Over three through six months | 4,431                    |
| Over six through 12 months    | 5,496                    |
| Over 12 months                | 22,765                   |
| Total                         | \$ 46,708                |

**Borrowings**



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Deposits are the primary source of funds of the Bank's lending and investment activities and for its general business purposes. The Bank may obtain advances from the Federal Home Loan Bank, ( FHLB ) of Pittsburgh to supplement its supply of lendable funds. Advances from the FHLB of Pittsburgh are typically secured by a pledge of the Bank's stock in the FHLB of Pittsburgh and a portion of the Bank's first mortgage loans and certain other assets. The Bank may also access the Federal Reserve Bank, ( FRB ) discount window. The following tables set forth the maximum month-end balance, period ending balance, and weighted average balance of outstanding FHLB and FRB advances at the dates and for the periods indicated, together with the applicable weighted average interest rates.

|                                | 2008                   | At December 31,<br>2007 | 2006       |
|--------------------------------|------------------------|-------------------------|------------|
|                                | (Dollars in thousands) |                         |            |
| FHLB advances                  | \$ 158,148             | \$ 153,221              | \$ 101,701 |
| FRB advances                   | \$ 10,000              | \$                      | \$         |
| Total advances                 | 168,148                | 153,221                 | 101,701    |
| Weighted average interest rate | 3.52%                  | 4.19%                   | 3.93%      |

|   | 2008                   | Years Ended December 31,<br>2007 | 2005       |
|---|------------------------|----------------------------------|------------|
|   | (Dollars in thousands) |                                  |            |
| Maximum balance of FHLB/FRB advances                | \$ 170,988             | \$ 153,221                       | \$ 148,538 |
| Weighted average balance of FHLB/FRB advances       | \$ 159,305             | \$ 112,277                       | \$ 124,013 |
| Weighted average interest rate of FHLB/FRB advances | 3.90%                  | 4.17%                            | 4.02%      |

**Subsidiary Activity**





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The Bank is permitted to invest up to 2% of its assets in the capital stock of, or secured or unsecured loans to, subsidiary corporations, with an additional investment of 1% of assets when such additional investment is utilized primarily for community development purposes. Under such limitations, as of December 31, 2008, the Bank was authorized to invest up to approximately \$14.7 million in the stock of, or loans to, service corporations (based upon the 2% limitation). In addition, the Bank can designate a subsidiary as an operating subsidiary, in which there is no percentage of assets investment limitation, if it engages only in activities in which it would be permissible for the Bank to engage. At December 31, 2008, the Bank had two wholly-owned subsidiaries, Third Delaware Corporation and Teragon Financial Corporation. Third Delaware Corporation was formed in 1998 for the purpose of investing in marketable securities. At December 31, 2008, the Bank had \$139.2 million invested in Third Delaware Corporation. During 2004, Teragon Financial Corporation ( Teragon ) invested \$7,500 in a limited partnership entitled Third Fed Abstract, L. P., whose purpose is to operate a title insurance agency, primarily to capture certain title insurance premiums generated by the Bank's lending activities. At December 31, 2008 the Bank had an investment of \$42.8 in Teragon. During 2006, Teragon was granted approval by the state of Pennsylvania to conduct business as an insurance agency, and during 2008, Teragon received \$21,000 of insurance commissions.

### **Personnel**



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As of December 31, 2008, the Company had 163 full-time and 33 part-time employees. None of the Company's employees are represented by a collective bargaining group. The Company believes that its relationship with its employees is good.

### **REGULATION**



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Set forth below is a brief description of all material laws and regulations which relate to the regulation of the Bank and the Company. The description does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

**Recent Legislation**





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The economy is experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system during the past year. Declines in the housing market during the past year, due to falling home prices and increased foreclosures and unemployment, have resulted in substantial declines in mortgage-related asset values, which has had a dramatic negative impact on government-sponsored entities and major commercial and investment banks.

Reflecting concern about the stability of the finance markets in general and the strength of counterparties, many lenders and institutional investors have reduced, and in some cases, ceased, to provide funding and liquidity to borrowers, including other financial institutions. In response to the financial crisis affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the EESA ) was signed into law. Pursuant to the EESA, specifically the Troubled Asset Relief Program ( TARP ) thereunder, the U.S. Treasury will have the authority to, among other things, purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, the Secretary of the Department of the Treasury announced the Department of the Treasury will purchase equity stakes in a wide variety of banks and thrifts through TARP s Capital Purchase Program ( CPP ). Under this program, from the \$700 billion authorized by the EESA, the Treasury made \$250 billion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, the Treasury received, from participating financial institutions, warrants to purchase common stock with an aggregate market price equal to 15% of the preferred stock investment. Participating financial institutions were required to adopt the Treasury s standards for executive compensation and corporate governance for the period during which the Treasury holds equity in such institution issued under the CPP. The Company did not participate in the CPP

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 ( ARRA ) was signed into law by President Obama. The ARRA includes a wide variety of programs intended to stimulate the economy and provide for extensive infrastructure, energy, health, and education needs. In addition, the ARRA imposes certain new executive compensation and corporate expenditure limits on all current and future TARP recipients until the institution has repaid the U.S. Treasury, which is now permitted under the ARRA without penalty and without the need to raise new capital, subject to the U.S. Treasury s consultation with the recipient s appropriate regulatory agency.

### **Company Regulation**



**General.** The Company is a unitary savings and loan holding company subject to regulatory oversight by the OTS. As such, the Company is required to register and file reports with the OTS and is subject to regulation and examination by the OTS. In addition, the OTS has enforcement authority over the Company and its non-savings association subsidiaries, which also permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings association. This regulation and oversight is intended primarily for the protection of the depositors of the Bank and not for the benefit of stockholders of the Company. The Company is also required to file certain reports with, and otherwise comply with, the rules and regulations of the OTS and the SEC.

**Sarbanes-Oxley Act of 2002.** The Sarbanes-Oxley Act of 2002 (the Act ) implemented legislative reforms intended to address corporate and accounting fraud and improve public company reporting. The SEC has promulgated new regulations pursuant to the Act and may continue to propose additional implementing or clarifying regulations as necessary in furtherance of the Act. The passage of the Act by Congress and the implementation of new regulations by the SEC subject publicly-traded companies to additional and more cumbersome reporting regulations and disclosure. Compliance with the Act and corresponding regulations may increase the Company's expenses.

**Financial Modernization.** The Gramm-Leach-Bliley Act ( GLB ) permits qualifying bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. GLB defines financial in nature to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. A qualifying national bank also may engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development, and real estate investment, through a financial subsidiary of the bank.

GLB also prohibits new unitary thrift holding companies from engaging in nonfinancial activities or from affiliating with a nonfinancial entity. As a grandfathered unitary thrift holding company, the Company has retained its authority to engage in nonfinancial activities.

**Qualified Thrift Lender Test.** As a unitary savings and loan holding company, the Company generally is not subject to activity restrictions, provided the Bank satisfies the QTL test. See Bank Regulation Qualified Thrift Lender Test. If the Company acquires control of another savings association as a separate subsidiary, it would become a multiple savings and loan holding company, and the activities of the Company and any of its subsidiaries (other than the Bank) would become subject to restrictions applicable to bank holding companies unless such other associations each also qualify as a QTL and were acquired in a supervisory acquisition.

#### **Bank Regulation**



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**General.** As a federally chartered, FDIC-insured savings association, the Bank is subject to extensive regulation by the OTS and the FDIC. Lending activities and other investments must comply with various federal statutory and regulatory requirements. The Bank is also subject to certain reserve requirements promulgated by the Federal Reserve Board.

The OTS, in conjunction with the FDIC, regularly examines the Bank and prepares reports for the consideration of the Bank's Board of Directors on any deficiencies that they find in the Bank's operations. The Bank's relationship with its depositors and borrowers is also regulated to a great extent by federal law, especially in such matters as the ownership of savings accounts and the form and content of the Bank's mortgage documents.

The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other savings institutions. This regulation and supervision establishes a comprehensive framework of

activities in which an institution can engage and is intended primarily for the protection of the FDIC and depositors. The regulatory structure also gives the regulatory authorities 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 regulations, whether by the OTS, the FDIC or the Congress could have a material adverse impact on the Company, the Bank and their operations. The Company is also required to file certain reports with, and otherwise comply with, the rules and regulations of the OTS and the SEC.

**Loan Limitations.** Regulations limit the amount of non-residential mortgage loans a savings institution may hold as a percentage of assets or capital. Separate from the qualified thrift lender test, regulations limit a savings institution to a maximum of 10% of its assets in large commercial loans (defined as loans in excess of \$2 million), with another 10% of assets permissible in small business loans. Commercial loans secured by real estate can be made in an amount up to four times an institution's capital. An institution can also have commercial leases, in addition to the above items, up to 10% of its assets. Commercial paper, corporate bonds, and consumer loans cannot collectively exceed 35% of an institution's assets. For this purpose, however, residential mortgage loans (including securities backed by such loans) and credit card loans are not considered consumer loans, and are both unlimited in amount.

**Deposit Insurance.** The Bank's deposits are insured to applicable limits by the FDIC. As an FDIC-insured bank, the Bank is subject to FDIC insurance assessments. Following enactment of the Federal Deposit Insurance Reform Act of 2005, the FDIC adopted a revised risk-based assessment system to determine assessment rates to be paid by FDIC-insured institutions. Under this revised assessment system, risk is defined and measured using an institution's supervisory ratings as well as certain other risk measures, including certain financial ratios. The annual rates for 2008 for institutions in Risk Category I range from 5 to 7 basis points and the rates for institutions in Risk Categories II, III and IV are 10, 28 and 43 basis points, respectively. These rates were offset by a one-time assessment credit held by an institution, based on the assessment base of that institution as of December 31, 1996, and in the future by dividends that may be declared by the FDIC if the reserve ratio of the Deposit Insurance Fund (DIF) increases above a certain amount. Deposit insurance premiums of \$247,300 were offset during 2008. The Company has \$225,000 of credits remaining to offset insurance premiums. The FDIC may raise or lower these assessment rates based on various factors to achieve reserve ratio, which the FDIC currently has set at 1.25 percent of insured deposits.

Due to the recent difficult economic conditions, deposit insurance per account owner has been raised to \$250,000 for all types of accounts until January 1, 2010. In addition, the FDIC adopted an optional Temporary Liquidity Guarantee Program by which, for a fee, noninterest bearing transaction accounts would receive unlimited insurance coverage until December 31, 2009 and, for a fee, certain senior unsecured debt issued by institutions and their holding companies between October 13, 2008 and June 30, 2009 would be guaranteed by the FDIC through June 30, 2012. The Bank made the business decision to participate in the unlimited noninterest bearing transaction account coverage. The assessments for unlimited noninterest bearing transaction account coverage will total 10 basis points per \$100 of insured deposits during 2009. The Bank and the Company elected not to participate in the unsecured debt guarantee program.

On October 16, 2008, the FDIC published a notice in the Federal Register concerning its establishment of the Federal Deposit Insurance Corporation Restoration Plan (the Restoration Plan). The Restoration Plan is a five year recapitalization plan for the DIF (subsequently amended to cover a seven-year time frame, as discussed below) based, in part, on significantly higher assessed DIF rates. Concurrent with the publication of the Restoration Plan, the FDIC issued a proposed rule to increase the DIF assessed rates for the first quarter of 2009 by 7 bps and, effective April 1, 2009, to make certain other changes regarding risk-based assessment and to set new deposit insurance rates. On December 22, 2008, the FDIC issued a final rule in which it invoked the good cause exception of the Administrative Procedures Act to waive the requirement that once finalized a rule must have a delayed effective date of 30 days from the publication date and, effective January 1, 2009, raised the first quarter 2009 DIF assessed rates by 7 bps. Under the final rule, for the first quarter of 2009, the new rates were expected to range between 12 and

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50 cents per \$100 in assessable deposits depending on the risk category to which an insured depository institution was assigned. Institutions in Risk Category I were charged a rate between 12 and 14 cents per \$100 in assessable deposits for the first quarter of 2009. Such an increase in the DIF assessed rates more than doubles the previous applicable rates for Tier I institutions.

On February 27, 2009 the FDIC amended the Restoration Plan for the DIF. Under the amended Restoration Plan, the FDIC extended the horizon from five years to seven years to raise the DIF reserve ratio to 1.15 percent, in recognition of the current significant strains on banks and the financial system and the likelihood of a severe recession. The amended Restoration Plan was accompanied by a final rule that sets assessment rates and makes adjustments to recognize how the assessment system differentiates for risk. Currently, most banks are in the best risk category and pay anywhere from 12 cents per \$100 of deposits to 14 cents per \$100 for insurance. Under the final rule, banks in this category will pay initial base rates ranging from 12 cents per \$100 to 16 cents per \$100 on an annual basis, beginning on April 1, 2009. Changes to the assessment system include higher rates for institutions that rely significantly on secured liabilities, which would increase the FDIC's loss in the event of institutional failure, without providing additional assessment revenue. Under the final rule, assessments will be higher for institutions that rely significantly on brokered deposits but, for well-managed and well-capitalized institutions, only when accompanied by rapid asset growth. The final rule also provides incentives in the form of a reduction in assessment rates for institutions to hold long-term unsecured debt and, for smaller institutions, high levels of Tier 1 capital.

On February 27, 2009, the FDIC proposed an additional amendment to the Restoration Plan for the DIF. This amendment proposes the imposition of a 20 basis point emergency special assessment on insured depository institutions as of June 30, 2009. The assessment is proposed to be collected on September 30, 2009. The interim rule would also permit the FDIC to impose an emergency special assessment after June 30, 2009, of up to ten basis points if necessary to maintain public confidence in federal deposit insurance. On March 5, 2009, FDIC Chairman Sheila Bair announced that if Congress adopts legislation expanding the FDIC's line of credit with Treasury from \$30 billion to \$100 billion, the FDIC might have the flexibility to reduce the special emergency assessment, possibly from 20 to 10 basis points. This assessment will be in addition to the new assessment rates which become effective April 1, 2009.

In addition to deposit insurance assessments, all FDIC-insured institutions are required to pay special assessments to the FDIC to fund the repayment of debt obligations of the Financing Corporation (FICO), a government-sponsored entity that was formed in 1987 to recapitalize the Federal Savings and Loan Insurance Corporation. At December 31, 2008, the annualized rate established by the FDIC for the FICO assessment was 1.14 basis points per \$100 of insured deposits. These assessments will continue until the FICO bonds mature in 2017.

**Regulatory Capital Requirements.** OTS capital regulations require savings institutions to meet three capital standards: (1) tangible capital equal to 1.5% of total adjusted assets, (2) a leverage ratio (core capital) equal to at least 4% of total adjusted assets and (3) a risk-based capital requirement equal to 8.0% of total risk-weighted assets. In addition, the OTS prompt corrective action regulation provides that a savings institution that has a leverage capital ratio of less than 4% (3% for institutions receiving the highest examination rating) will be deemed to be undercapitalized and may be subject to certain restrictions.

At December 31, 2008, the Bank was in compliance with all of its regulatory capital requirements.

**Dividend and Other Capital Distribution Limitations.** The Bank may not declare or pay a cash dividend on its capital stock if the effect thereof would be to reduce the regulatory capital of the Bank below the amount required for the liquidation account established at the time of the Bank's mutual-to-stock conversion.

Savings associations that would remain at least adequately capitalized following the capital distribution, and that meet other specified requirements, are not required to file a notice or application for capital distributions (such as cash dividends) declared below specified amounts. Savings associations which are eligible for expedited treatment under current OTS regulations are not required to file an application with the OTS if (i) the savings association would remain at least adequately capitalized following the capital distribution and (ii) the amount of capital distribution does not exceed an amount equal to the savings association's net income for that year to date, plus the savings association's retained net income for the previous two calendar years. Thus, only undistributed net income for the prior two years may be distributed in addition to the current year's undistributed net income without the filing of an application with the OTS. Savings associations which do not qualify for expedited treatment or which desire to make a capital distribution in excess of the specified amount, must file an application with, and obtain the approval of, the OTS prior to making the capital distribution. A savings association such as the Bank that is a subsidiary of a savings and loan holding company, and under certain other circumstances, must file a notice with OTS prior to making the capital distribution.

**Qualified Thrift Lender Test.** The Home Owners' Loan Act (HOLA), as amended, requires savings institutions to meet a QTL test. If the Bank maintains an appropriate level of Qualified Thrift Investments (primarily residential mortgages and related investments, including certain mortgage-backed securities) (QTIs) and otherwise qualifies as a QTL, it will continue to enjoy full borrowing privileges from the FHLB of Pittsburgh. The required percentage of QTIs is 65% of portfolio assets (defined as all assets minus intangible assets, property used by the institution in conducting its business and liquid assets equal to 10% of total assets). Certain assets are subject to a percentage limitation of 20% of portfolio assets. In addition, savings associations may include shares of stock of the FHLBs, FNMA and FHLMC as qualifying QTIs. The method for measuring compliance with the QTL test requires an institution to be in compliance nine out of every 12 months. As of December 31, 2008, the Bank was in compliance with its QTL requirement with 73% of its assets invested in QTIs.

**Federal Home Loan Bank System.** The Bank is a member of the FHLB of Pittsburgh, one of 12 regional FHLBs that administer the home financing credit function of savings associations. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans to members (*i.e.*, advances) in accordance with policies and procedures established by the Board of Directors of the FHLB.



As a member, the Bank is required to purchase and maintain an investment in the capital stock of the FHLB of Pittsburgh in an amount equal to 4.55% of its advances outstanding from the FHLB plus 0.55% of its unused borrowing capacity. At December 31, 2008, the Bank had \$10.0 million in FHLB stock, which was in compliance with this requirement.

**Federal Reserve System.** The Federal Reserve Board requires all depository institutions to maintain non-interest bearing reserves at specified levels against their transaction accounts (primarily checking, NOW and Super NOW checking accounts) and non-personal time deposits. The balances maintained to meet the reserve requirements imposed by the Federal Reserve Board may be used to satisfy the liquidity requirements that are imposed by the OTS. At December 31, 2008, the Bank's total transaction accounts required a reserve level of \$50,000 which was offset by the Bank's vault cash on hand and cash on deposit at the Federal Reserve Bank of Philadelphia.

Savings associations have authority to borrow from the Federal Reserve Bank's discount window. Other short-term borrowings at December 31, 2008 include advances from the Federal Reserve Bank totaling \$10.0 million maturing in three months with an interest rate of 0.50%.

**Item 1A. Risk Factors**

Not applicable.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

The Company is located and conducts its business at 3 Penns Trail, Newtown, Pennsylvania. At December 31, 2008, the Bank operated from its administrative offices and fourteen branch offices located in Philadelphia and Bucks Counties, Pennsylvania and Mercer County, New Jersey. The Bank also owns two parcels of land and a building behind its Doylestown branch office. The parcel with the building is available to be leased to a third-party and the other parcel is used as a parking lot for employees of the Bank and tenants. The net book value of the two lots was \$100,000. In addition, a subsidiary of the Company, Penns Trail Development Corporation, owns investment property with a book value of \$738,000.

The following table sets forth certain information regarding the Bank's operating properties:

| Location  | Leased or Owned | Location  | Leased or Owned |
|---|-----------------|---|-----------------|
| <b>ADMINISTRATIVE OFFICE</b><br>Newtown Office<br>3 Penns Trail<br>Newtown, PA 18940                  | Owned           |   |                 |
| <b>DEPOSIT OPERATIONS</b><br>828C Newtown-Yardley Road<br>Suite 301B<br>Newtown, PA 18940             | Leased          | <b>PROCESSING OPERATIONS</b><br>Operations Center<br>62 Walker Lane<br>Newtown, PA 18940(1) | Owned           |
| <b>BRANCH AND LOAN OFFICES</b><br>Frankford Office<br>4625 Frankford Avenue<br>Philadelphia, PA 19124 | Leased          | Newtown Office<br>950 Newtown Yardley Road<br>Newtown, PA 18940                             | Leased          |
| Ewing Office<br>2075 Pennington Road<br>Ewing, NJ 08618   | Owned           | Mayfair Office<br>Roosevelt Blvd. at Unruh<br>Philadelphia, PA 19149                        | Owned           |
| Hamilton Office   | Owned           | Doylestown Office   | Owned           |

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|  |       |   |        |
|--|-------|---|--------|
| 1850 Route 33<br>Hamilton Square, NJ 08690                               |       | 60 North Main Street<br>Doylestown, PA 18901                        |        |
| Fishtown Office<br>York & Memphis Streets<br>Philadelphia, PA 19125      | Owned | Feasterville Office<br>Buck Hotel Complex<br>Feasterville, PA 19053 | Leased |
| Cross Keys Office<br>834 North Easton Highway<br>Doylestown, PA 18901    | Owned | Woodhaven Office<br>4014 Woodhaven Road<br>Philadelphia, PA 19154   | Leased |
| Bridesburg Office<br>Orthodox & Almond Streets<br>Philadelphia, PA 19137 | Owned | Girard Office<br>136 West Girard Avenue<br>Philadelphia, PA 19123   | Leased |

|  |        |   |        |
|--|--------|---|--------|
| New Britain Office<br>600 Town Center<br>New Britain, PA 18901 | Leased | Northern Liberties Office<br>905 North 2nd Street<br>Philadelphia, PA 19123 | Leased |
|--|--------|---|--------|

**Item 3. Legal Proceedings**

Neither the Company nor its subsidiaries are involved in any pending legal proceedings, other than routine legal matters occurring in the ordinary course of business that in the aggregate involve amounts which are believed by management to be immaterial to the consolidated financial condition or results of operations of the Company.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**PART II**

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

Information relating to the market for Registrant's common equity and related stockholder matters appears under the section captioned "Stock Market Information" in the Registrant's 2008 Annual Report to Stockholders and is incorporated herein by reference.

The following table provides information on repurchases by the Company of its common stock in each month for the three months ended December 31, 2008:

| Month                              | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan or Program | Maximum Number of Shares that may yet be Purchased Under the Plans or Programs |
|------------------------------------|----------------------------------|------------------------------|--|--|
| October 1, 2008 - October 31, 2008 | 120,450                          | \$ 18.84                     |  | 123,057  |

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|                                      |        |    |       |        |         |
|--------------------------------------|--------|----|-------|--------|---------|
| November 1, 2008 - November 30, 2008 | 15,700 | \$ | 19.32 | 15,700 | 107,357 |
| December 1, 2008 - December 31, 2008 | 5,400  | \$ | 19.16 | 5,400  | 101,957 |

**Item 6.** Selected Financial Data

The above-captioned information appears under the section captioned "Selected Financial and Other Data" in the Registrant's 2008 Annual Report to Stockholders and is incorporated herein by reference.

**Item 7.** Management's Discussion and Analysis of Financial Condition and Results of Operations

The information under the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Registrant's 2008 Annual Report to Stockholders is incorporated herein by reference.

**Item 7A.** Quantitative and Qualitative Disclosures about Market Risk

The information under the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Registrant's 2008 Annual Report to Stockholders is incorporated herein by reference.

**Item 8.** Financial Statements and Supplementary Data

The Consolidated Financial Statements of TF Financial Corporation and its subsidiaries included in the Registrant's 2008 Annual Report to Stockholders are incorporated herein by reference.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A(T). Controls and Procedures**

**(a) Disclosure Controls and Procedures**

Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)), the Company's principal executive officer and principal financial officer have concluded that as of the end of the period covered by this Annual Report on Form 10-K such disclosure controls and procedures are effective.

**(b) Internal Control Over Financial Reporting**

Management's report on internal control over financial reporting is included in the Registrant's 2008 Annual Report to Stockholders and is incorporated herein by reference. Neither this Annual Report on Form 10K nor the Annual Report to Stockholders includes an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to the temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report on Form 10-K.

**(c) Changes in Internal Control Over Financial Reporting.**

During the last quarter of the year under report, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information contained under the sections captioned Proposal 1 - Election of Directors General Information and Nominees and Biographical Information and Additional Information About Directors and Executive Officers Section 16(a) Beneficial Ownership Reporting Compliance in the Registrant's definitive proxy statement for the Registrant's 2009 Annual Meeting of Stockholders (the Proxy Statement) is incorporated herein by reference.

The Company has adopted a Code of Ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or persons performing such functions. The Code of Ethics can be obtained without charge by sending a written request to the Corporate Secretary, TF Financial Corporation, 3 Penns Trail, Newtown, Pennsylvania 18940.

**Item 11. Executive Compensation**

The information relating to executive compensation is incorporated herein by reference to the information contained under the sections captioned Executive Compensation and Director Compensation in the Registrant's Proxy Statement.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

(a) Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the Section captioned "Voting Securities and Principal Holders Thereof" in the Registrant's Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the sections captioned "Security Ownership of Certain Beneficial Owners and Management" and Proposal 1 "Election of Directors" in the Registrant's Proxy Statement.

(c) Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the registrant.

(d) Securities Authorized for Issuance Under Equity Compensation Plans

Set forth below is information as of December 31, 2008 with respect to compensation plans under which equity securities of the Registrant are authorized for issuance.



**EQUITY COMPENSATION PLAN INFORMATION**

|   | (a)<br>Number of securities<br>to be issued upon<br>exercise of<br>outstanding options,<br>warrants and rights |           | (b)<br>Weighted-average<br>exercise price of<br>outstanding<br>options, warrants<br>and rights |  | (c)<br>Number of securities<br>remaining available for<br>future issuance under<br>equity compensation plans<br>(excluding securities<br>reflected in column (a)) |
|---|--|-----------|--|--|---|
| Equity compensation plans approved by<br>shareholders(1)  | 287,336  | \$        | 25.67  |  | 2,000   |
| Equity compensation plans not approved by<br>shareholders |  |           |  |  |   |
| <b>TOTAL</b>  | <b>287,336</b>   | <b>\$</b> | <b>25.67</b>   |  | <b>2,000</b>  |

(1) Plans approved by stockholders include: TF Financial Corporation 1997 Stock Option Plan, and TF Financial Corporation 2005 Stock-Based Incentive Plan.

For information regarding the material features of these plans, see Notes A10, A11, J3 and J4 to the Consolidated Financial Statements included as part of Exhibit 13 to this report.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information relating to certain relationships and related transactions is incorporated herein by reference to the information contained under the section captioned "Additional Information About Directors and Executive Officers - Certain Relationships and Related Transactions and Director Independence" in the Registrant's Proxy Statement.

**Item 14. Principal Accountant Fees and Services**

The information relating to this item is incorporated herein by reference to the information contained under the section captioned "Principal Accounting Firm Fees" in the Registrant's Proxy Statement.

**PART IV****Item 15. Exhibits and Financial Statement Schedules**

(a) The following documents are filed as a part of this report:

(1) The following financial statements and the report of the independent auditor of the Company included in the Company's 2008 Annual Report to Stockholders are incorporated herein by reference.

**Report of Independent Registered Public Accounting Firm**

Consolidated Statements of Financial Condition as of December 31, 2008 and 2007

Consolidated Statements of Income For the Years Ended December 31, 2008 and 2007

Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income for the Years Ended December 31, 2008 and 2007

Consolidated Statements of Cash Flows for the Years Ended December 31, 2008 and 2007

Notes to Consolidated Financial Statements

(2) All schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(3) Exhibits

(a) The following exhibits are filed as part of this report.

|       |  |
|-------|--|
| 3.1   | Certificate of Incorporation of TF Financial Corporation (1)               |
| 3.2   | Bylaws of TF Financial Corporation (1)                                     |
| 4.0   | Stock Certificate of TF Financial Corporation (1)                          |
| 10.1  | Third Federal Savings and Loan Association Management Stock Bonus Plan (1) |
| 10.2  | Third Federal Savings Bank Directors Consultation and Retirement Plan (2)  |
| 10.3  | Severance Agreement with Kent C. Lufkin (3)                                |
| 10.4  | Severance Agreement with Floyd P. Haggar (3)                               |
| 10.5  | Severance Agreement with Dennis R. Stewart (4)                             |
| 10.6  | TF Financial Corporation 1997 Stock Option Plan (5)                        |
| 10.7  | Severance Agreement with Robert N. Dusek (6)                               |
| 10.8  | TF Financial Corporation 1996 Directors Stock Option Plan (7)              |
| 10.9  | Retirement and Non-Competition Agreement with John R. Stranford (8)        |
| 10.10 | Employment Agreement with John R. Stranford (8)                            |
| 10.11 | TF Financial Corporation Incentive Compensation Plan (9)                   |
| 10.12 | TF Financial Corporation 2005 Stock-Based Incentive Plan (10)              |
| 10.13 | Severance Agreement with Elizabeth Kaspern (11)                            |
| 10.14 | TF Financial Corporation Stock Repurchase Plan (12)                        |
| 10.15 | TF Financial Corporation Amended and Restated Bylaws (13)                  |
| 13.0  | 2008 Annual Report to Stockholders   |
| 21.0  | Subsidiary Information   |
| 23.0  | Consent of Independent Registered Public Accounting Firm                   |
| 31.1  | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002    |
| 31.2  | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002    |
| 32.0  | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002    |

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(1) Incorporated herein by reference to the Exhibits to Form S-1, Registration Statement, File No. 33-76960.

(2) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.

(3) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

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(4) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.

(5) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997.

(6) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

(7) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

(8) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

(9) Incorporated herein by reference to the Registrant's Form 8-K filed with the Securities and Exchange Commission on October 20, 2004.

- (10) Incorporated herein by reference to the Registrant's Form S-8 filed with the Securities and Exchange Commission on May 20, 2005.
- (11) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.
- (12) Incorporated herein by reference to the Registrant's Form 8-K filed with the Securities and Exchange Commission on October 25, 2007.
- (13) Incorporated herein by reference to the Registrant's Form 8-K filed with the Securities and Exchange Commission on October 26, 2007.

**SIGNATURES**

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

**TF FINANCIAL CORPORATION**

Dated: March 30, 2009

By: /s/ Kent C. Lufkin  
Kent C. Lufkin  
President, Chief Executive Officer  
(Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated as of Dated: March 30, 2009.

By: /s/ Kent C. Lufkin  
Kent C. Lufkin  
President, Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Dennis R. Stewart  
Dennis R. Stewart  
Executive Vice President, Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)

By: /s/ Carl F. Gregory  
Carl F. Gregory  
Director

By: /s/ Robert N. Dusek  
Robert N. Dusek  
Chairman of the Board

By: /s/ Dennis L. McCartney  
Dennis L. McCartney  
Director

By: /s/ George A. Olsen  
George A. Olsen  
Director

By: /s/ Albert M. Tantala, Sr.  
Albert M. Tantala, Sr.  
Director

By: /s/ John R. Stranford  
John R. Stranford  
Director