SI Financial Group, Inc.
Form 10-K
March 30, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2005

¨ **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: 0-50801

SI FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

United States	**84-1655232**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
803 Main Street, Willimantic, Connecticut	**06226**
(Address of principal executive offices)	**(Zip Code)**

(860) 423-4581

(Registrant s telephone number, including area code)

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

None

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

Common Stock, par value $0.01 per share

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

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

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

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 or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was $57.3 million, which was computed by reference to the closing price of $11.66, at which the common equity was sold as of June 30, 2005. Solely for the purposes of this calculation, the shares held by SI Bancorp, MHC and the directors and officers of the registrant are deemed to be affiliates.

As of March 15, 2006, there were 12,499,586 shares of the registrant s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

SI FINANCIAL GROUP, INC.

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Forward-Looking Statements

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of SI Financial Group, Inc. (the Company). These forward-looking statements are generally identified by the use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. The Company s ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, national and regional economic conditions, legislative and regulatory changes, monetary and fiscal policies of the United States government, including policies of the United States Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company s market area, changes in real estate market values in the Company s market area and changes in relevant accounting principles and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

PART I.

Item 1. Business.

General

In certain instances where appropriate, the terms we, us and our refer to SI Financial Group, Inc. and Savings Institute Bank and Trust Company or both.

SI Financial Group, Inc. was established on August 6, 2004 to become the parent holding company for Savings Institute Bank and Trust Company (the Bank or Savings Institute) upon the conversion of the Bank s former parent, SI Bancorp, Inc., from a state-chartered to a federally-chartered mutual holding company. At the same time, the Bank also converted from a state-chartered to a federally-chartered savings bank. The Bank is a wholly-owned subsidiary of the Company and management of the Company and the Bank are substantially similar. The Company neither owns nor leases any property, but instead uses the premises, equipment and other property of the Bank. Thus, the financial information and discussion contained herein primarily relates to the activities of the Bank.

The Bank was incorporated by an act of the Connecticut legislature in 1842 under the name Willimantic Savings Institute. It was shortened to Savings Institute in 1991 to reflect the Bank s expanded geographic territory. In 2000, the Bank converted to stock form and became the wholly-owned subsidiary of SI Bancorp, Inc., a Connecticut-chartered mutual holding company. On August 6, 2004, Savings Institute converted to a federal charter and now operates under the name Savings Institute Bank and Trust Company. At that time, SI Bancorp, Inc. converted to a federal charter operating under the name SI Bancorp, MHC and transferred all of the common stock of the Bank to SI Financial Group, Inc. On September 30, 2004, the Company completed its minority stock offering with the sale of 5,025,500 shares of its common stock to the public, 251,275 shares contributed to SI Financial Group Foundation and 7,286,975 issued to SI Bancorp, MHC.

The Bank operates as a community-oriented financial institution offering a full range of financial services to consumers and businesses in its market area, including insurance, trust and investment services. The Bank attracts deposits from the general public and uses those funds to originate one- to four-family residential, multi-family and commercial real estate, commercial business and consumer loans, which it holds primarily for investment.

Asset Purchase

On November 15, 2005, the Company acquired certain assets of two trust services businesses, Private Trust Services and Bank Trust Services (SI Trust Servicing), from the former Circle Trust Company headquartered in Darien, Connecticut. SI Trust Servicing, located in Rutland, Vermont, is a third-party provider of trust outsourcing services for community banks. The acquisition presents significant growth opportunities in the Bank s wealth management business and is expected to increase noninterest income and be accretive to earnings.

Availability of Information

The Company s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are made available free of charge on the Company s website, www.mysifi.com, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission (the SEC). The information on the Company s website shall not be considered as incorporated by reference into this Form 10-K.

Market Area

The Company is headquartered in Willimantic, Connecticut, which is located in eastern Connecticut approximately 30 miles east of Hartford. The Bank operates seventeen offices in Windham, New London, Tolland and Hartford Counties, which the Bank considers its primary market area. The economy in its market area is primarily oriented to the educational, service, entertainment, manufacturing and retail industries.

The major employers in the area include several institutions of higher education, the Mohegan Sun and Foxwoods casinos, General Dynamics Defense Systems and Pfizer, Inc. According to published statistics, Windham County s population in 2005 was approximately 115,000 and consisted of 43,000 households. The population increased approximately 5.6% from 2000. Median household income in Windham County is $49,000, compared to $59,000 for Connecticut as a whole and $44,000 nationally. The surrounding counties of Hartford, New London and Tolland Counties have median household incomes of $56,000, $55,000 and $65,000, respectively.

Competition

The Bank faces significant competition for the attraction of deposits and origination of loans. The most direct competition for deposits has historically come from the several financial institutions operating in the Bank s market area and, to a lesser extent, from other financial service companies, such as brokerage firms, credit unions and insurance companies. The Bank also faces competition for investors funds from money market funds and other corporate and government securities. At June 30, 2005, which is the most recent date for which data is available from the Federal Deposit Insurance Corporation (FDIC), the Bank held approximately 18.28% of the deposits in Windham County, which is the largest market share out of 11 financial institutions with offices in this county. Also, at June 30, 2005, the Bank held approximately 0.82% of the deposits in Hartford, New London and Tolland Counties, which is the 15th market share out of 35 financial institutions with offices in these counties. Banks owned by Bank of America Corp., Webster Bank Financial Corporation, TD Banknorth Group, Inc., Sovereign Bancorp., Inc. and Citizens Financial Group, Inc., all of which are large regional bank holding companies, also operate in the Bank s market area. These institutions are significantly larger and, therefore, have significantly greater resources than the Bank does and may offer products and services that the Bank does not provide.

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The Bank s competition for loans comes primarily from financial institutions in its market area, and to a lesser extent from other financial service providers, such as mortgage companies and mortgage brokers. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage market, such as insurance companies, securities companies and specialty finance companies.

The Bank expects competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered barriers to entry, allowed banks to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Changes in federal law permit affiliation among banks, securities firms and insurance companies, which promotes a competitive environment in the financial services industry. Competition for deposits and the origination of loans could limit the Company s growth in the future.

Lending Activities

General. The Bank s loan portfolio consists primarily of one- to four-family residential mortgage loans, multi-family and commercial real estate loans and commercial business loans. To a much lesser extent, the loan portfolio includes construction and consumer loans. The Bank historically and currently originates loans primarily for investment purposes. At December 31, 2005, the Bank had $107,000 in loans that were held for sale.

The following table summarizes the composition of the Bank s loan portfolio in dollar amounts and as a percentage of the respective portfolio at the dates indicated.

	At December 31,									
	2005		2004		2003		2002		2001	
(Dollars in Thousands)	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Real estate loans:										
Residential 1 to 4 family	$ 266,739	51.66%	$ 252,180	55.99%	$ 226,881	58.29%	$ 213,831	63.29%	$ 193,672	65.36%
Multi-family and commercial	100,926	19.54	82,213	18.25	73,428	18.87	61,214	18.12	56,376	19.02
Construction	47,325	9.16	35,773	7.94	20,652	5.30	21,104	6.25	10,155	3.43
Total real estate loans	414,990	80.36	370,166	82.18	320,961	82.46	296,149	87.66	260,203	87.81
Consumer loans:										
Home equity	20,562	3.98	18,335	4.07	14,411	3.70	10,786	3.19	7,752	2.62
Other	3,294	0.64	2,790	0.62	3,107	0.80	3,936	1.16	7,174	2.42
Total consumer loans	23,856	4.62	21,125	4.69	17,518	4.50	14,722	4.35	14,926	5.04
Commercial business loans	77,552	15.02	59,123	13.13	50,746	13.04	27,003	7.99	21,192	7.15
Total loans	516,398	100.00%	450,414	100.00%	389,225	100.00%	337,874	100.00%	296,321	100.00%
Deferred loan origination costs, net of fees	1,048		743		387		(209)		(349)	
Allowance for loan losses	(3,671)		(3,200)		(2,688)		(3,067)		(2,861)	
Loans, net	$ 513,775		$ 447,957		$ 386,924		$ 334,598		$ 293,111	

One- to Four-Family Residential Loans. The Bank s primary lending activity is the origination of mortgage loans to enable borrowers to purchase or refinance existing homes or to construct new residential dwellings in its market area. The Bank offers fixed-rate and adjustable-rate mortgage loans with terms up to 30 years. Borrower demand for adjustable-rate loans versus fixed-rate loans is a function of the level of interest rates, the expectations of changes in the level of interest rates, the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and the initial period interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate mortgage loans and adjustable-rate mortgage loans that can be originated at any time is largely determined by the demand for each in a competitive environment and the effect each has on the Bank s interest rate risk. The loan fees charged, interest rates and other provisions of mortgage loans are determined on the basis of the Bank s own pricing criteria and competitive market conditions.

The Bank offers fixed-rate loans with terms of 15, 20 or 30 years. The Bank s adjustable-rate mortgage loans are based on 15, 20 or 30 year amortization schedules. Interest rates and payments on adjustable-rate mortgage loans adjust annually after a one, three, five, seven or 10-year initial fixed period. Interest rates and payments on adjustable-rate loans are adjusted to a rate typically equal to 2.75% (2.875% for jumbo loans) above the one-year constant maturity Treasury index. The maximum amount by which the interest rate may be increased or decreased is generally 2% per adjustment period and the lifetime interest rate cap is generally 6% over the initial interest rate of the loan.

While the Bank anticipates that adjustable-rate loans will better offset the adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make the Bank s asset base more responsive to changes in interest rates, the extent of this interest sensitivity is limited by the annual and lifetime interest rate adjustment limits.

Generally, the Bank does not originate conventional loans with loan-to-value ratios exceeding 95% and generally originates loans with a loan-to-value ratio in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. The Bank requires all properties securing mortgage loans to be appraised by a board approved independent licensed appraiser and requires title insurance on all first mortgage loans. Borrowers must obtain hazard insurance and flood insurance for loans on property located in a flood zone, before closing the loan.

In an effort to provide financing for moderate income and first-time buyers, the Bank offers Federal Housing Authority, Veterans Administration and Connecticut Housing Finance Agency loans and a first-time home buyers program. The Bank offers fixed-rate residential mortgage loans through these programs to qualified individuals and originates the loans using modified underwriting guidelines.

Multi-Family and Commercial Real Estate Loans. The Bank offers fixed-rate and adjustable-rate mortgage loans secured by multi-family and commercial real estate. The Bank s multi-family and commercial real estate loans are generally secured by condominiums, apartment buildings, single-family subdivisions as well as owner occupied properties located in its market area and used for businesses. The Bank intends to continue to emphasize this segment of its loan portfolio.

The Bank originates adjustable-rate multi-family and commercial real estate loans for terms up to 25 years. Interest rates and payments on these loans typically adjust every five years after a five-year initial fixed-rate period. Interest rates and payments on adjustable-rate loans are adjusted to a rate typically

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2.5-3.5% above the classic advance rates offered by the Federal Home Loan Bank of Boston (the FHLB). There are no adjustment period or lifetime interest rate caps. Loans are secured by first mortgages that generally do not exceed 75% of the property s appraised value. At December 31, 2005, the largest outstanding multi-family or commercial real estate loan commitment was $3.0 million, of which $2.9 million was outstanding. This loan is secured by the assets of a healthcare facility and was performing according to its terms at December 31, 2005.

Loans secured by multi-family and commercial real estate generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in multi-family and commercial real estate lending is the borrower s creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and 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. To monitor cash flows on income properties, the Bank requires borrowers and loan guarantors, if any, to provide annual financial statements on multi-family and commercial real estate loans. In reaching a decision on whether to make a multi-family or commercial real estate loan, consideration is given to the net operating income of the property, the borrower s expertise, credit history and profitability and the value of the underlying property. In addition, with respect to commercial real estate rental properties, the Bank will also consider the term of the lease and the quality of the tenants. The Bank generally requires that the properties securing these real estate loans have debt service coverage ratios of at least 1.20. The debt service coverage ratio is equal to cash flows before interest, depreciation and required principal payments divided by amounts paid for interest and required principal payments. Environmental surveys are generally required for commercial real estate loans over $250,000.

Construction and Land Loans. The Bank originates loans to individuals, and to a lesser extent, builders, to finance the construction of residential dwellings. The Bank also originates construction loans for commercial development projects, including condominiums, apartment buildings, single-family subdivisions as well as owner-occupied properties used for businesses. Construction loans generally provide for the payment of interest only during the construction phase, which is usually twelve months. At the end of the construction phase, the loan generally converts to a permanent mortgage loan. Loans generally can be made with a maximum loan to value ratio of 85% on residential construction and 75% on commercial construction of the lower of appraised value or cost of the project, whichever is less. At December 31, 2005, the largest outstanding residential construction loan commitment was for $1.3 million, all of which was outstanding. At December 31, 2005, the largest outstanding commercial construction loan commitment was $7.3 million, of which $2.8 million was outstanding. These loans were performing according to their terms at December 31, 2005. Primarily all commitments to fund construction loans require an appraisal of the property by a board approved independent licensed appraiser. Also, inspections of the property are required before the disbursement of funds during the term of the construction loan.

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 depends 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, we may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, the Bank may be confronted, at or before the maturity of the loan, with a project having a value which is insufficient to assure full repayment. As a result of the foregoing, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the

borrower or guarantor to repay principal and interest. If the Bank is forced to foreclose on a project before or at completion due to a default, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

The Bank also originates land loans to individuals and local contractors and developers only for the purpose of making improvements on approved building lots, subdivisions and condominium projects within two years of the date of the loan. Such loans to individuals generally are written with a maximum loan-to-value ratio based upon the appraised value or purchase price of the land of 75% for a 10-year loan and 60% for a 15-year loan, whichever is less. The Bank offers fixed-rate land loans and variable-rate land loans that adjust annually. Interest rates and payments on adjustable-rate land loans are adjusted to a rate typically equal to 2.75% above the one-year constant maturity Treasury index. The maximum amount by which the interest rate may be increased or decreased is generally 2% annually and the lifetime interest rate cap is generally 6% over the initial rate of the loan. If applicable, title insurance and a hazardous waste survey reporting that the land is free of hazardous or toxic waste is required.

Commercial Business Loans. The Bank originates commercial business loans to a variety of professionals, sole proprietorships and small businesses primarily in its market area. The Bank offers a variety of commercial lending products, the maximum amount of which is limited by the Bank s in-house loans-to-one-borrower limit, which was $6.0 million at December 31, 2005. The largest commercial loan was a $1.0 million loan secured by business assets, real estate and Small Business Administration guarantee, of which $983,000 was outstanding as of December 31, 2005. This loan was performing according to its terms at December 31, 2005.

The Bank offers loans secured by business assets other than real estate, such as business equipment and inventory. These loans are originated with maximum loan-to-value ratios of 75% of the value of the personal property. The Bank originates lines of credit to finance the working capital needs of businesses to be repaid by seasonal cash flows or to provide a period of time during which the business can borrow funds for planned equipment purchases. These loans convert to a term loan at the expiration of a draw period, which is not to exceed twelve months and will be paid over a pre-defined amortization period. Additional products such as time notes, letters of credit and Small Business Administration guaranteed loans are offered.

When originating commercial business loans, the Bank considers the financial statements of the borrower, the borrower s payment history of both corporate and personal debt, the debt service capabilities of the borrower, the projected cash flows of the business, viability of the industry in which the customer operates and the value of the collateral.

Unlike residential mortgage loans, which generally are made on the basis of the borrower s ability to make repayment from his or her employment or other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial loans are of higher risk and typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

The Bank offers equipment lease financing to its commercial customers. Financing is available up to 100% of the leased equipment and amortized over a period of one to three years. All commercial leasing loans, totaling $1.4 million, were performing according to terms at December 31, 2005.

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Consumer Loans. The Bank offers a variety of consumer loans, primarily home equity lines of credit, and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles as well as unsecured loans. Unsecured loans generally have a maximum borrowing limit of $15,000 and a maximum term of five years.

The procedures for underwriting consumer loans include an assessment of the applicant s payment history on other debts and their ability to meet existing obligations and payments on the proposed loans. Although the applicant s creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount. Home equity lines of credit have adjustable rates of interest that are indexed to the prime rate as reported in *The Wall Street Journal.* The Bank will offer home equity loans with maximum combined loan-to-value ratios of 100%, provided that loans in excess of 80% will be charged a higher rate of interest. A home equity line of credit may be drawn down by the borrower for an initial period of five years from the date of the loan agreement. During this period, the borrower has the option of paying, on a monthly basis, either principal and interest or only interest. If not renewed, the borrower has to pay back the amount outstanding under the line of credit over a term not to exceed ten years, beginning at the end of the five-year period.

Consumer loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections depend on the borrower s continuing financial stability, and therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

Loan Originations, Purchases, Sales and Servicing. Loan originations come from a number of sources. The primary source of loan originations are the Bank s in-house loan originators, and to a lesser extent, local mortgage brokers, advertising and referrals from customers.

From time to time, the Bank will purchase whole participations in loans fully guaranteed by the United States Department of Agriculture and the Small Business Administration. The loans are primarily for commercial and agricultural properties located throughout the United States. The Bank purchased $22.2 million and $12.2 million of these loans in fiscal 2005 and 2004, respectively.

The Bank generally originates loans for portfolio but from time to time will sell loans in the secondary market, primarily fixed-rate one- to four-family residential mortgage loans with servicing retained, based on prevailing market interest rate conditions, an analysis of the composition and risk of the loan portfolio, liquidity needs and interest rate risk management. Generally, loans are sold without recourse. The Bank utilizes the proceeds from these sales primarily to meet liquidity needs and manage interest rate risk. The Bank sold $35.5 million, $15.5 million and $23.0 million of loans in the years ended December 31, 2005, 2004 and 2003, respectively.

At December 31, 2005, the Bank retained the servicing rights on $71.7 million of loans for others, consisting primarily of fixed-rate mortgage loans sold with or without recourse to third parties. Loan repurchase commitments are agreements to repurchase loans previously sold upon the occurrence of conditions established in the contract, including default by the underlying borrower. Loans sold with recourse totaled $66,000 at December 31, 2005. Loan servicing includes collecting and remitting loan

payments, accounting for principal and interest, contacting delinquent mortgagors, processing insurance and tax payments on behalf of borrowers, assisting in foreclosures and property dispositions when necessary and general administration of loans. The gross servicing fee income from loans sold with servicing rights retained is typically 25 or 37.5 basis points of the total balance of serviced loans. The servicing rights, included in other assets, related to these loans was $373,000 and $165,000 at December 31, 2005 and 2004, respectively. Amortization of mortgage servicing rights totaled $64,000, $24,000 and $0 for the years ended December 31, 2005, 2004 and 2003, respectively.

The following table sets forth the Bank s loan originations, loan purchases, loan sales, principal repayments, charge-offs and other reductions on loans for the years indicated.

	Years Ended December 31,		
(Dollars in Thousands)	**2005**	**2004**	**2003**
Loans at beginning of year	$ 450,414	$ 389,225	$ 337,874
Originations:			
Real estate loans	154,166	147,899	180,962
Commercial business loans	12,635	14,465	10,034
Consumer loans	17,011	16,063	16,682
Total loan originations	183,812	178,427	207,678
Purchases	22,211	12,152	26,448
Deductions:			
Principal loan repayments, prepayments and other, net	104,126	113,766	156,963
Loan sales	35,534	15,549	22,996
Loan charge-offs	29	75	2,113
Transfers to other real estate owned	350		703
Total deductions	140,039	129,390	182,775
Net increase in loans	65,984	61,189	51,351
Loans at end of year	$ 516,398	$ 450,414	$ 389,225

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Loan Maturity. The following table shows the contractual maturity of the Bank s loan portfolio at December 31, 2005. The table does not reflect any estimate of prepayments, which significantly shortens the average life of all loans, and may cause actual repayment experience to differ from that shown below. Demand loans having no stated schedule of repayment and no stated maturity are reported as due in one year or less.

	Amounts Due In			
(Dollars in Thousands)	One Year or Less	More Than One Year to Five Years	More Than Five Years	Total Amount Due
Real estate loans:				
Residential 1 to 4 family	$ 31	$ 4,653	$ 262,055	$ 266,739
Multi-family and commercial	287	2,504	98,135	100,926
Construction	10,469	1,999	34,857	47,325
Total real estate loans	10,787	9,156	395,047	414,990
Commercial business loans	7,379	8,262	61,911	77,552
Consumer loans	1,542	14,860	7,454	23,856
Total loans	$ 19,708	$ 32,278	$ 464,412	$ 516,398

While one- to four-family residential real estate loans are normally originated with up to 30-year terms; such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon the sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase, sale and refinancing activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.

The following table sets forth, at December 31, 2005, the dollar amount of gross loans receivable contractually due after December 31, 2006, and whether such loans have either fixed interest rates, floating or adjustable interest rates. The amounts shown below exclude deferred loan fees and costs and the allowance for loan losses and include $240,000 of nonperforming loans.

	Due After December 31, 2006		
(Dollars in Thousands)	Fixed Rates	Floating or Adjustable Rates	Total
Real estate loans:			
Residential 1 to 4 family	$ 200,451	$ 66,257	$ 266,708
Multi-family and commercial	9,787	90,852	100,639
Construction	28,382	8,474	36,856
Total real estate loans	238,620	165,583	404,203
Commercial business loans	38,133	32,040	70,173
Consumer loans	8,397	13,917	22,314
Total loans	$ 285,150	$ 211,540	$ 496,690

***Loan Approval Procedures and Authority*.** The Bank s lending activities follow written, nondiscriminatory, underwriting standards and loan origination procedures established by the Board of Directors and management. All residential mortgages and consumer home equity lines of credit in excess of $6.0 million or all commercial loans and other consumer loans in excess of $2.0 million require the approval of the Board of Directors. The Loan Committee of the Board of Directors has the authority to approve: (1) residential mortgage loans and consumer home equity lines of credit of up to $6.0 million and (2) commercial and other consumer loans of up to $2.0 million. The President and the Senior Credit Officer have approval for: (1) residential mortgage loans that conform to Fannie Mae and Freddie Mac standards up to $2.0 million or $359,650 for those that are non-conforming, (2) consumer and commercial loans up to $250,000 individually or $2.0 million jointly for consumer home equity lines of credit or $1.0 million jointly for commercial and other consumer loans. The Senior Commercial Officer may approve home equity lines of credit and commercial loans of up to $200,000 individually or $500,000 with the additional approval of the President or Senior Credit Officer. Various bank personnel have been delegated authority to approve loans up to $359,650.

***Loans to One Borrower*.** The maximum amount that the Bank may lend to one borrower and the borrower s related entities is limited, by regulation, to generally 15% of the Bank s stated capital and reserves. At December 31, 2005, the Bank s regulatory limit on loans to one borrower was $9.9 million. At that date, the Bank s largest lending relationship was $8.6 million representing two commercial business loans and a commercial construction loan for the construction of convalescent homes, of which $2.9 million was outstanding and performing according to the original repayment terms at December 31, 2005.

***Loan Commitments*.** The Bank issues commitments for fixed-rate and adjustable-rate mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements to lend to customers and generally expire in 90 days or less from the date of application.

***Delinquencies*.** When a borrower fails to make a required loan payment, the Bank takes a number of steps to have the borrower cure the delinquency and restore the loan to current status. The Bank makes initial contact with the borrower when the loan becomes 15 days past due. If payment is not then received by the 30th day of delinquency, additional letters and phone calls generally are made. When the loan becomes 90 days past due, a letter is sent notifying the borrower that foreclosure proceedings will commence if the loan is not brought current within 30 days. Generally, when the loan becomes 120 days past due, the Bank will commence foreclosure proceedings against any real property that secures the loan or attempts to repossess any personal property that secures a consumer or commercial 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 is typically sold at foreclosure. The Bank may consider loan repayment arrangements with certain borrowers under certain circumstances.

On a monthly basis, management informs the Board of Directors of the amount of loans delinquent more than 30 days, all loans in foreclosure and all foreclosed and repossessed property.

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The following table sets forth the delinquencies in the Bank s loan portfolio as of the dates indicated.

	December 31, 2005				December 31, 2004			
	60 89 Days		90 Days or More		60 89 Days		90 Days or More	
(Dollars in Thousands)	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans
Real estate loans:								
Residential 1 to 4 family		$	1	$ 80	5	$ 547	2	$ 522
Multi-family and commercial			1	74			3	421
Construction								
Total real estate loans			2	154	5	547	5	943
Consumer loans:								
Home equity					1	20		
Other			2	5			1	1
Total consumer loans			2	5	1	20	1	1
Commercial business loans								
Total delinquent loans [1]		$	4	$ 159	6	$ 567	6	$ 944

[1] Represents delinquent loans 60 days or more past due.

Classified Assets. Management of the Bank, including the Managed Asset Committee, consisting of a number of the Bank s officers, review and classify the assets of the Bank on a monthly basis and the Board of Directors reviews the results of the reports on a quarterly basis. Federal regulations and the Bank s internal policies require that management utilize an internal asset classification system to monitor and evaluate the credit risk inherent in its loan portfolio. The Bank currently classifies problem and potential problem assets as *substandard, doubtful, loss* or *special mention.* An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those assets that are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets characterized as doubtful have all the weaknesses inherent in those classified as substandard with the additional characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, questionable, and there is a high probability of loss. Assets classified as loss are those assets considered uncollectible and of such little value that their continuance as assets, without the establishment of a specific loss reserve, is not warranted. In addition, assets that do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess credit deficiencies or potential weaknesses are required to be designated special mention. When an asset is classified as substandard or doubtful, a specific allowance for loan losses may be established. If an asset is classified as a loss, the Bank charges-off an amount equal to the portion of the asset classified as loss. All the loans mentioned above are included in the Bank s Managed Asset Report. This report serves as an integral part in the evaluation of the adequacy of the Bank s allowance for loan losses.

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The following table sets forth the principal balance of the Bank s classified loans as of December 31, 2005.

(Dollars in Thousands)	Loss	Doubtful	Substandard	Special Mention
Real estate loans:				
Residential 1 to 4 family	$	$	$ 643	$ 217
Multi-family and commercial			74	1,078
Construction				
Total real estate loans			717	1,295
Consumer loans:				
Home equity				
Other		15	5	
Total consumer loans		15	5	
Commercial business loans			266	110
Total classified loans	$	$ 15	$ 988	$ 1,405

At December 31, 2005, the Bank had no loss rated loans and two loans rated as doubtful. Of the $988,000 of substandard loans at December 31, 2005, $224,000 are considered nonperforming loans. The largest substandard loan is $204,000, which is no more than 30 days past due. Of the $1.4 million of special mention loans, no loan was more than 30 days past due at December 31, 2005.

Nonperforming Assets and Restructured Loans. When a loan becomes 90 days delinquent, the loan is placed on nonaccrual status at which time the accrual of interest ceases and the allowance for any uncollectible accrued interest is established and charged against operations. Typically, payments received on nonaccrual loans are applied to the outstanding principal and interest balance as determined at the time of collection of the loan.

The Bank considers repossessed assets and loans that are 90 days or more past due to be nonperforming assets. Real estate acquired as a result of foreclosure or by deed-in-lieu of foreclosure is classified as real estate owned until it is sold. When property is acquired it is recorded at the lower of its cost, which is the unpaid balance of the loan plus foreclosure costs or fair value at the date of the foreclosure. Holding costs and declines in fair value after acquisition of the property are charged against income as incurred.

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The following table provides information with respect to the Bank s nonperforming assets and troubled debt restructurings as of the dates indicated.

(Dollars in Thousands)	December 31, 2005	2004	2003	2002	2001
Nonaccrual loans:					
Real estate loans	$ 224	$ 943	$ 1,295	$ 1,347	$ 1,597
Commercial business loans				418	517
Consumer loans	16	1		72	29
Total nonaccrual loans	240	944	1,295	1,837	2,143
Accruing loans past due 90 days or more:					
Real estate loans				5	46
Commercial business loans					1
Consumer loans					
Total accruing loans past due 90 days or more				5	47
Total nonperforming loans	240	944	1,295	1,842	2,190
Real estate owned, net [1]	325		328	43	43
Total nonperforming assets	565	944	1,623	1,885	2,233
Troubled debt restructurings	74	76	77	78	78
Total nonperforming assets and troubled debt restructurings	$ 639	$ 1,020	$ 1,700	$ 1,963	$ 2,311
Ratios:					
Total nonperforming loans to total loans	0.05%	0.21%	0.33%	0.55%	0.74%
Total nonperforming loans to total assets	0.03	0.15	0.25	0.38	0.51
Total nonperforming assets and troubled debt restructurings to total assets	0.09	0.16	0.33	0.40	0.54

(1) Real estate owned balances are shown net of related loss allowance.

In addition to the loans disclosed in the above table, at December 31, 2005, the Bank identified eight loans totaling $764,000 in which the borrowers had possible credit problems that caused management to have doubts about the ability of the borrowers to comply with the present loan repayment terms and that may result in the future inclusion of such loans in the table above. The aforementioned loans have been classified as substandard and are contained in the classified loan table on the previous page.

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Interest income that would have been recorded for the year ended December 31, 2005 had nonaccruing loans and troubled debt restructurings been current in accordance with their original terms and had been outstanding throughout the period amounted to $15,000. The amount of interest related to nonaccrual loans and troubled debt restructurings included in interest income was $5,000 for the year ended December 31, 2005.

Allowance for Loan Losses. The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loans are charged against the allowance for loan losses when management believes that the uncollectibility of principal is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received. The Bank evaluates the allowance for loan losses on a monthly basis.

The methodology for assessing the appropriateness of the allowance for loan losses consists of the following key elements:

Specific allowances for identified problem loans, including certain impaired or collateral-dependent loans;

General valuation allowance on certain identified problem loans;

General valuation allowance on the remainder of the loan portfolio; and

Unallocated component

Specific Allowance on Identified Problem Loans. The loan portfolio is segregated first between loans that are on the Bank s Managed Asset Report and loans that are not. The Managed Asset Report includes: (1) loans that are 60 or more days delinquent, (2) loans with anticipated losses, (3) loans referred to attorneys for collection or in the process of foreclosure, (4) nonaccrual loans, (5) loans classified as substandard, doubtful, loss or special mention by either the Bank s internal classification system or by regulators during the course of their examination of the Bank and (6) troubled debt restructurings and other nonperforming loans.

The Managed Asset Committee, consisting of Bank officers, reviews each loan on the Managed Asset Report and may establish an individual reserve allocation on certain loans based on such factors as (1) the strength of the customer s personal or business cash flow; (2) the availability of other sources of repayment; (3) the amount due or past due; (4) the type and value of collateral; (5) the strength of the borrower s collateral position; (6) the estimated cost to sell the collateral; and (7) the borrower s effort to cure the delinquency.

The Bank also reviews and establishes, as needed, a specific allowance for certain identified non-homogeneous problem loans. In accordance with the Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan* as amended by Statement of Financial Accounting Standards No. 118, *Accounting by Creditors for Impairment of a Loan- an amendment of FASB Statement No. 114*, a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due under the contractual terms of the loan agreement. Measurement of the impairment is based on the present value of expected future cash flows or the fair value of the collateral, if the loan is collateral dependent. A specific allowance on impaired loans is established if the present value of the expected future cash flows, or fair value of the collateral for collateral dependent loans, is lower than the carrying value of the loan.

General Valuation Allowance on Certain Identified Problem Loans. The Bank establishes a general allowance for loans on the Managed Asset Report that do not have an individual allowance. The Bank segregates

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these loans by loan category and assigns allowance percentages to each category based on inherent losses associated with each type of lending and consideration that these loans, in the aggregate, represent an above-average credit risk and that more of these loans will prove to be uncollectible compared to loans in the general portfolio.

General Valuation Allowance on the Remainder of the Loan Portfolio. The Bank establishes another general allowance for loans that are not on the Managed Asset Report to recognize the probable losses associated with lending activities, but which, unlike specific allowances, has not been allocated to particular problem assets. This general valuation allowance is determined by segregating the loans by loan category and assigning allowance percentages based on the Bank s historical loss experience and delinquency trends. The allowance may be adjusted for significant factors that, in management s judgment, affect the collectibility of the portfolio as of the evaluation date. These significant factors may include changes in lending policies and procedures, changes in existing general economic and business conditions affecting the Bank s primary lending areas, credit quality trends, collateral value, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions within portfolio segments, recent loss experience in particular segments of the portfolio, duration of the current business cycle and bank regulatory examination results. The applied loss factors are re-evaluated annually to ensure their relevance in the current economic environment.

Unallocated Component. An unallocated component is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Although management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and the Company s results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while management believes it has established its allowance for loan losses in conformity with generally accepted accounting principles, there can be no assurance that regulators, in reviewing the Bank s loan portfolio, will not request the Bank to increase its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses would adversely affect the Company s financial condition and results of operations.

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

	Years Ended December 31,				
(Dollars in Thousands)	**2005**	**2004**	**2003**	**2002**	**2001**
Allowance at beginning of year	$ 3,200	$ 2,688	$ 3,067	$ 2,861	$ 2,605
Provision for loan losses	410	550	1,602	537	440
Charge-offs:					
Real estate loans	(17)		(1,523)	(77)	(40)
Commercial business loans	(1)	(13)	(374)	(111)	(218)
Consumer loans	(11)	(62)	(216)	(218)	(146)
Total charge-offs	(29)	(75)	(2,113)	(406)	(404)
Recoveries:					
Real estate loans	70	19	89	35	40
Commercial business loans	3	6	24	32	161
Consumer loans	17	12	19	8	19
Total recoveries	90	37	132	75	220
Net recoveries (charge-offs)	61	(38)	(1,981)	(331)	(184)
Allowance at end of year	$ 3,671	$ 3,200	$ 2,688	$ 3,067	$ 2,861
Ratios:					

Allowance to total loans outstanding at end of year	0.71%	0.71%	0.69%	0.91%	0.97%
Allowance to nonperforming loans	1529.58	338.98	207.57	166.50	130.64
Net recoveries (charge-offs) to average loans outstanding during the year	0.01	(0.01)	(0.55)	(0.11)	(0.07)
Recoveries to charge-offs	310.34	49.30	6.25	18.47	54.46

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The Bank recorded net recoveries of $61,000 in 2005, as compared to net charge-offs for the prior years presented in the above table. The strong level of recoveries of previously charged-off loans and low charge-offs for 2005 were attributable to the quality loan portfolio with conservative underwriting practices and strong collection efforts. Charge-offs for 2003 included the charge-off of two commercial business loans and two commercial real estate loans that aggregated $1.8 million. The larger of the two commercial real estate loans, which at the time of charge-off had a principal balance of $1.6 million, was charged-off after the loan was nonperforming and the Bank determined that the value of the real estate underlying the loan was insufficient to cover the outstanding principal balance. Additionally, because we held a junior collateral position, the Bank determined that the likelihood of any recovery was remote. During the year ended December 31, 2003, charge-offs exceeded the provision for loan losses as specific allowances of $237,000 were established in prior periods for a portion of the charged-off loans once it had been determined that collection or liquidation in full was unlikely.

The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated.

	December 31,								
	2005			2004			2003		
(Dollars in Thousands)	**Amount**	**% of Allowance in each Category to Total Allowance**	**% of Loans in each Category to Total Loans**	**Amount**	**% of Allowance in each Category to Total Allowance**	**% of Loans in each Category to Total Loans**	**Amount**	**% of Allowance in each Category to Total Allowance**	**% of Loans in each Category to Total Loans**
Real estate loans	$ 2,639	71.89%	80.36%	$ 2,403	75.08%	82.18%	$ 2,093	77.86%	82.46%
Commercial business	892	24.29	15.02	641	20.02	13.13	461	17.15	13.04
Consumer loans	140	3.82	4.62	152	4.74	4.69	80	2.98	4.50
Unallocated				4	0.16		54	2.01	
Total allowance for loan losses	$ 3,671	100.00%	100.00%	$ 3,200	100.00%	100.00%	$ 2,688	100.00%	100.00%

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	December 31,					
	2002			2001		
(Dollars in Thousands)	Amount	% of Allowance in each Category to Total Allowance	% of Loans in each Category to Total Loans	Amount	% of Allowance in each Category to Total Allowance	% of Loans in each Category to Total Loans
Real estate loans	$ 2,237	72.94%	87.66%	$ 1,866	65.22%	87.81%
Commercial business	488	15.91	7.99	647	22.62	7.15
Consumer loans	318	10.37	4.35	277	9.68	5.04
Unallocated	24	0.78		71	2.48	
Total allowance for loan losses	$ 3,067	100.00%	100.00%	$ 2,861	100.00%	100.00%

Investment Activities

The Company has legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies, government-sponsored enterprises, state and municipal governments, mortgage-backed securities and certificates of deposit of federally-insured institutions. Within certain regulatory limits, the Company also may invest a portion of its assets in corporate securities and mutual funds. The Company is also required to maintain an investment in FHLB stock. While the Company has the authority under applicable law and its investment policies to invest in derivative securities, the Company had no such investments at December 31, 2005.

The Company s primary source of income continues to be derived from its loan portfolio. The investment portfolio is mainly used to meet the cash flow needs of the Company, provide adequate liquidity for the protection of customer deposits and yield a favorable return on investments. The type of securities and the maturity periods are dependent on the composition of the loan portfolio, interest rate risk, liquidity position and tax strategies of the Company. The Company s investment objectives are to provide and maintain liquidity, to maintain a balance of high quality, diversified investments to minimize risk, to provide collateral for pledging requirements, to establish an acceptable level of interest rate and credit risk, to provide an alternate source of low-risk investments when demand for loans is weak, to generate a favorable return and to assist in the financing needs of various local public entities, subject to credit quality review and liquidity concerns. The Company s Board of Directors has the overall responsibility for the investment portfolio, including approval of the investment policy and appointment of the Investment Committee. The Investment Committee is responsible for approval of investment strategies and monitoring investment performance. The execution of specific investment initiatives and the day-to-day oversight of the Company s investment portfolio is the responsibility of the Chief Executive Officer and the Chief Financial Officer. These officers, and others designated by the Board, are authorized to execute investment transactions up to specified limits based on the type of security without prior approval of the Investment Committee. Transactions exceeding these limitations require the approval of two of these officers, one of whom must be either the President and Chief Executive Officer or the Chief Financial Officer. Individual investment transactions are reviewed and approved by the Board of Directors on a monthly basis, while portfolio composition and performance are reviewed at least quarterly by the Investment Committee.

Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115), requires that securities be categorized as either held to maturity, trading securities or available for sale based on management s intent as to the ultimate disposition of each security. Debt securities may be classified as held to maturity, and reported in the financial

statements at amortized cost, only if the Company has the positive intent and ability to hold those securities until maturity. Securities purchased and held principally for the purpose of trading in the near term are classified as trading securities. These securities are reported at fair value in the financial statements, with unrealized gains and losses recognized in earnings. Debt and equity securities not classified as either held to maturity or trading securities are classified as available for sale securities. These securities are reported at fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income, net of taxes.

At December 31, 2005, the Company s investment portfolio, which consisted solely of available for sale securities, totaled $120.0 million and represented 17.3% of assets. The Company s available for sale securities consisted primarily of government-sponsored enterprises with maturities of six years or less, U.S. government and agency securities with maturities of 15 years or less, mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae with stated final maturities of 25 years or less, and corporate debt securities and securities of state and municipal governments.

The following table sets forth the amortized costs and fair values of the Company s securities portfolio at the dates indicated.

	December 31,					
	2005		2004		2003	
(Dollars in Thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Available for sale securities:						
U.S. Government and agency securities	$ 4,820	$ 4,813	$ 6,039	$ 6,066	$ 7,139	$ 7,239
Government-sponsored enterprises	73,135	71,490	67,911	67,610	31,444	31,760
Mortgage-backed securities	37,346	36,538	40,926	40,594	19,050	18,364
Corporate debt securities	4,537	4,528	3,498	3,563	15,540	16,451
Obligations of state and political subdivisions	1,499	1,546	1,499	1,584	3,129	3,217
Tax-exempt	490	490	560	560		
Other debt securities	75	74	75	75	75	75
Total debt securities	121,902	119,479	120,508	120,052	76,377	77,106
Marketable equity securities	555	540	488	505	531	587
Total available for sale securities	122,457	120,019	120,996	120,557	76,908	77,693
Held to maturity securities:						
Mortgage-backed securities					1,728	1,344
Total securities	$ 122,457	$ 120,019	$ 120,996	$ 120,557	$ 78,636	$ 79,037

The Company had no investments that had an aggregate book value in excess of 10% of its stockholders equity at December 31, 2005.

The following table sets forth the amortized cost, weighted average yields and contractual maturities of securities at December 31, 2005. Weighted average yields on tax-exempt securities are not presented on a tax equivalent basis because the impact would be insignificant. Certain mortgage-backed securities have adjustable interest rates and will reprice periodically within the various maturity ranges. These repricing schedules are not reflected in the table below. At December 31, 2005, mortgage-backed securities with adjustable rates totaled $10.4 million.

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	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
(Dollars in Thousands)	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
U.S. government and agency securities	$ 2,017	2.48%	$ 215	5.10%	$ 1,220	5.82%	$ 1,368	5.63%	$ 4,820	4.34%
Government-sponsored enterprises	6,499	2.66	64,885	3.67	1,751	3.96			73,135	3.59
Mortgage-backed securities	1	8.41	1,978	5.32	6,774	4.01	28,593	4.53	37,346	4.48
Corporate debt securities							4,537	5.22	4,537	5.22
Obligations of state and political subdivisions			999	6.80			500	5.67	1,499	6.42
Tax-exempt securities	70	3.88	280	3.88	140	3.88			490	3.88
Other debt securities	25	5.50	50	5.63					75	5.58
Total debt securities	8,612	2.64	68,407	3.77	9,885	4.22	34,998	4.68	121,902	3.99
Marketable equity securities							555	3.30	555	3.30
Total available for sale securities	$ 8,612	2.64	$ 68,407	3.77	$ 9,885	4.22	$ 35,553	4.66	$ 122,457	3.99

Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major sources of the Company s funds for lending and other investment purposes. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and money market conditions.

Deposit Accounts. Substantially all of the Bank s depositors are residents of the State of Connecticut. Deposits are attracted from within the Bank s market area through the offering of a broad selection of deposit instruments, including NOW, money market accounts, regular savings accounts and certificates of deposit. The Bank also utilizes brokered certificates of deposits, which at December 31, 2005 amounted to $5.0 million, as an alternate source of funds. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rates offered, among other factors. In determining the terms of the Bank s deposit accounts, the Bank considers the rates offered by its competition, liquidity needs, profitability, matching deposit and loan products and customer preferences and concerns. The Bank generally reviews its deposit mix and pricing weekly. The Bank s current strategy is to offer competitive rates, and even higher rates on long-term deposits, but not be the market leader in every account type and maturity.

The Bank also offers a variety of deposit accounts designed for the businesses operating in its market area. Business banking deposit products include a commercial checking account that provides an earnings credit to offset monthly service charges and a checking account specifically designed for small business and nonprofit organizations. Additionally, sweep accounts and money market accounts are available for businesses. The Bank has sought to increase its commercial deposits through the offering of these products, particularly to its commercial borrowers and to local municipalities.

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The following table sets forth the deposit activity for the years indicated, including mortgagors and investors escrow accounts and brokered deposits.

(Dollars in Thousands)	Years Ended December 31, 2005	2004	2003
Beginning balance	$ 460,480	$ 417,311	$ 398,315
Increase before interest credited	43,265	36,833	12,389
Interest credited	8,537	6,336	6,607
Net increase in deposits	51,802	43,169	18,996
Ending balance [1]	$ 512,282	$ 460,480	$ 417,311

(1) Includes mortgagors and investors escrow accounts in the amount of $3.0 million, $2.7 million and $2.2 million at December 31, 2005, 2004 and 2003, respectively. Includes brokered deposits of $5.0 million at December 31, 2005, 2004 and 2003.

The following table sets forth the distribution of the Bank s deposit accounts for the dates indicated.

	December 31, 2005		2004		2003	
(Dollars in Thousands)	Balance	% of Total	Balance	% of Total	Balance	% of Total
Noninterest-bearing demand deposits	$ 51,996	10.15%	$ 46,049	10.00%	$ 40,371	9.67%
NOW and money market accounts	125,156	24.43	110,564	24.01	101,852	24.41
Savings accounts [1]	90,879	17.74	95,310	20.70	89,846	21.53
Certificates of deposit [2]	244,251	47.68	208,557	45.29	185,242	44.39
Total deposits	$ 512,282	100.00%	$ 460,480	100.00%	$ 417,311	100.00%

(1) Includes mortgagors and investors escrow accounts in the amount of $3.0 million, $2.7 million and $2.2 million at December 31, 2005, 2004 and 2003, respectively.

(2) Includes brokered deposits of $5.0 million at December 31, 2005, 2004 and 2003.

The Bank had $65.0 million of certificates of deposit of $100,000 or more outstanding as of December 31, 2005, maturing as follows:

(Dollars in Thousands)	Amount	Weighted Average Rate
Maturity Period:		
Three months or less	$ 8,923	3.58%
Over three through six months	5,685	2.73
Over six through twelve months	16,606	3.91
Over twelve months	33,766	4.09
Total	$ 64,980	3.85%

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The following table presents the amount of certificates of deposit accounts outstanding by the various rate categories, years to maturity and percent of total certificate accounts at December 31, 2005.

(Dollars in Thousands)	Amount Due Less Than One Year	One to Two Years	Two to Three Years	Three to Four Years	More Than Four Years	Total	Percent of Total Certificate Accounts
1.24 2.00%	$ 36,303	$ 2,394	$ 18	$	$	$ 38,715	15.85%
2.01 3.00%	25,632	12,581	321	304		38,838	15.90
3.01 4.00%	16,603	15,462	8,575	5,723	250	46,613	19.09
4.01 5.00%	49,088	31,628	18,377	1,674	8,492	109,259	44.73
5.01 6.00%	2,094	8,195	4	302		10,595	4.34
6.01 6.78%	149	82				231	0.09
Total	$ 129,869	$ 70,342	$ 27,295	$ 8,003	$ 8,742	$ 244,251	100.00%

Borrowings. The Bank utilizes advances from the FHLB to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The FHLB functions as a central reserve bank providing credit for member financial institutions. As a member, the Bank is required to own capital stock in the FHLB and is authorized to apply for advances on the security of such stock and certain mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to creditworthiness have been met. Advances are made under several different programs, each having its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution s net worth or on the FHLB s assessment of the institution s creditworthiness. Under its current credit policies, the FHLB generally limits advances to 25% of a member s assets, and short-term borrowings of less than one year may not exceed 10% of the institution s assets. The FHLB determines specific lines of credit for each member institution.

Advances from the FHLB increased $15.3 million, or 21.0%, for the year ended December 31, 2005 to $87.9 million. The new advances, which have longer durations, were obtained to mitigate interest rate risk by matching the durations of the longer-term mortgage loans in the loan portfolio. The increased borrowings were used as a supplement to deposits to fund asset growth.

Junior Subordinated Debt Owed to Unconsolidated Trust. To a lesser extent, the Company has utilized the proceeds raised from the issuance of trust preferred securities. In 2002, SI Capital Trust I (the Trust), a business trust formed by SI Bancorp, MHC (formerly SI Bancorp, Inc.), issued $7.0 million of preferred securities in a private placement and issued approximately 217 shares of common stock at $1,000 par value to SI Bancorp, MHC. The Trust used the proceeds of these issuances to purchase $7.2 million of SI Bancorp, MHC s floating rate junior subordinated deferrable interest debentures. The interest rate on the debentures and the trust preferred securities is variable and adjustable quarterly at 3.70% over the six-month LIBOR. The interest rate on these securities at December 31, 2005 was 8.15%. A rate cap of 11.00% is effective through April 22, 2007. On September 24, 2004, all of the common stock of SI Capital Trust I was contributed to the Company from SI Bancorp, MHC, at which point, SI Capital Trust I became an unconsolidated subsidiary of the Company.

The debentures are the sole assets of SI Capital Trust I and are subordinate to all of the Company s existing and future obligations for borrowed money, its obligations under letters of credit and certain

derivative contracts and any guarantees by the Company of any such obligations. The trust preferred securities generally rank equal to the trust common securities in priority of payment, but rank before the trust common securities if and so long as the Company fails to make principal or interest payments on the debentures. Concurrently with the issuance of the debentures and the trust preferred and common securities, the Company issued a guarantee related to the trust securities for the benefit of the holders. SI Bancorp, MHC s obligations under the guarantee and the Company s obligations under the debentures, the related indenture and the trust agreement relating to the trust securities, constitute a full and unconditional guarantee by the Company of the obligations of SI Capital Trust I under the trust preferred securities.

The stated maturity of the debentures is April 22, 2032. In addition, the debentures are subject to redemption at par at the option of the Company, subject to prior regulatory approval, in whole or in part on any interest payment date after April 22, 2007. The debentures are also subject to redemption before April 22, 2007 at a specified price after the occurrence of certain events that would either have a negative tax effect on SI Capital Trust I or the Company or would result in SI Capital Trust I being treated as an investment company that is required to be registered under the Investment Company Act of 1940. Upon repayment of the debentures at their stated maturity or following their redemption, the Trust will use the proceeds of such repayment to redeem an equivalent amount of outstanding trust preferred securities and trust common securities.

Additionally, the Company occasionally utilizes collateralized borrowings, which represent loans sold that do not meet the criteria for derecognition, due primarily to recourse and other provisions that could not be measured at the date of transfer. Such borrowings are derecognized when all recourse and other provisions that could not be measured at the time of transfer either expire or become measurable. The Company had no collateralized borrowings at December 31, 2005.

The following table sets forth information regarding the Company s borrowings at the dates or for the years indicated.

(Dollars in Thousands)	**At or For the Years Ended December 31,**		
	2005	**2004**	**2003**
Maximum amount of advances outstanding at any month-end during the year:			
FHLB advances	$ 93,190	$ 72,674	$ 57,168
Subordinated debt	7,217	7,217	7,217
Other borrowings			1,951
Average balance outstanding during the year:			
FHLB advances	$ 79,596	$ 65,154	$ 46,693
Subordinated debt	7,217	7,217	7,217
Other borrowings			1,233
Weighted average interest rate during the year:			
FHLB advances	3.90%	4.12%	4.66%
Subordinated debt	6.86	5.14	4.99
Other borrowings			6.00
Balance outstanding at end of year:			
FHLB advances	$ 87,929	$ 72,674	$ 57,168
Subordinated debt	7,217	7,217	7,217
Other borrowings			
Weighted average interest rate at end of year:			
FHLB advances	3.97%	3.80%	4.29%
Subordinated debt	8.15	5.92	4.85
Other borrowings			

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Trust Services

The Bank s trust department provides fiduciary services, investment management and retirement services, to individuals, partnerships, corporations and institutions. Additionally, conservatorships and executorships are provided under various trust, wills and other agreements. The Bank has implemented comprehensive policies governing the practices and procedures of the trust department, including policies relating to investment of trust property, maintaining confidentiality of trust records, avoiding conflicts of interest and maintaining impartiality. Consistent with its operating strategy, the Bank will continue to emphasize the growth of its trust business in order to accumulate assets and increase fee-based income. At December 31, 2005, trust assets under administration were $147.3 million, consisting of 364 accounts, the largest of which totaled $8.0 million, or 5.4% of the trust department s total assets. The acquisition of SI Trust Servicing, in Rutland, Vermont, in November 2005 represented an opportunity for significant growth of the Bank s wealth management business. SI Trust Servicing offers third-party trust outsourcing services to other community banks located throughout the country. As of December 31, 2005, SI Trust Servicing provided trust outsourcing services to thirteen clients, consisting of 4,767 accounts totaling $4.59 billion in assets. For the years ended December 31, 2005, 2004 and 2003, total trust services revenue was $1.0 million, $631,000 and $596,000, respectively.

Subsidiary Activities

The Company has one subsidiary other than the Savings Institute Bank and Trust Company. In 2002, SI Capital Trust I was established as a statutory trust under Delaware law as a wholly-owned subsidiary of SI Bancorp, MHC for the purpose of issuing trust preferred securities. SI Capital Trust I issued trust preferred securities on April 10, 2002. All of the common stock of SI Capital Trust I was contributed to the Company from SI Bancorp, MHC on September 24, 2004. At that point, SI Capital Trust I became a wholly-owned subsidiary of the Company. In accordance with Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities,* SI Capital Trust I is not consolidated for financial reporting purposes.

The following are descriptions of the Bank s wholly-owned subsidiaries.

803 Financial Corp . 803 Financial Corp. was established in 1995 as a Connecticut corporation to maintain an ownership interest in a third-party registered broker-dealer, Infinex Investments, Inc. Infinex operates offices at the Bank and offers customers a complete range of nondeposit investment products, including mutual funds, debt, equity and government securities, retirement accounts, insurance products and fixed and variable annuities. The Bank receives a portion of the commissions generated by Infinex from sales to customers. For the years ended December 31, 2004 and 2003, the Bank received fees of $184,000 and $121,000, respectively, through its relationship with Infinex. Due to a regulatory restriction on federally-chartered thrifts, on December 31, 2004, 803 Financial Corp. sold its interest in Infinex which was subsequently purchased by SI Financial Group, Inc. As of December 31, 2005 and 2004, 803 Financial Corp. had no other holdings or business activities.

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SI Realty Company, Inc. SI Realty, established in 1999 as a Connecticut corporation, holds real estate owned by the Bank, including foreclosure properties. At December 31, 2005, SI Realty had $539,000 in assets.

SI Mortgage Company. In January 1999, the Bank formed SI Mortgage to manage and hold loans secured by real property. SI Mortgage qualifies as a passive investment company, which exempts it from Connecticut income tax under current law. Income tax savings to the Bank from the use of a passive investment company was approximately $245,000 and $92,000 for the years ended December 31, 2005 and 2004, respectively.

Personnel

At December 31, 2005, the Company had 206 full-time employees and 40 part-time employees. None of the Company s employees are represented by a collective bargaining unit. The Company believes its relationship with its employees is good.

REGULATION AND SUPERVISION

General

The Bank is subject to extensive regulation, examination and supervision by the Office of Thrift Supervision (OTS), as its primary federal regulator, and the FDIC, as its deposits insurer. The Bank is a member of the Federal Home Loan Bank System and its deposit accounts are insured up to applicable limits by the Bank Insurance Fund managed by the FDIC. The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals before entering into certain transactions such as mergers with, or acquisitions of, other financial institutions. There are periodic examinations by the OTS and, under certain circumstances, the FDIC, to evaluate the Bank s safety and soundness and compliance with various regulatory requirements. This regulatory structure is intended primarily for the protection of the insurance fund 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 policies, whether by the OTS, the FDIC or Congress, could have a material adverse impact on the Company, SI Bancorp, MHC and the Bank and their operations. The Company and SI Bancorp, MHC, as savings and loan holding companies, are required to file certain reports with, are subject to examination by, and otherwise must comply with the rules and regulations of the OTS. The Company is also subject to the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Certain of the regulatory requirements that are applicable to the Bank, the Company and SI Bancorp, MHC are described below. This description of statutes and regulations is not intended to be a complete explanation of such statutes and regulations and their effects on the Bank, the Company and SI Bancorp, MHC are qualified in their entirety by reference to the actual statutes and regulations.

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Regulation of Federal Savings Associations

Business Activities. Federal law and regulations, primarily the Home Owners Loan Act and the regulations of the OTS, govern the activities of federal savings banks, such as the Bank. These laws and regulations delineate the nature and extent of the activities in which federal savings banks may engage. In particular, certain lending authority for federal savings banks, *e.g.*, commercial, non-residential real property loans and consumer loans, is limited to a specified percentage of the institution s capital or assets.

Capital Requirements. The OTS s capital regulations require federal savings institutions to meet three minimum capital standards:

- a tangible capital ratio requirement of 1.5% of adjusted total assets;
- a leverage ratio of 4% of Tier 1 (core) capital to adjusted total assets (3% for institutions receiving the highest rating on the CAMELS examination rating system); and
- a risk-based capital ratio requirement of 8% of total capital (core and supplementary capital) to total risk-weighted assets of which at least half must be core capital

In addition, the prompt corrective action standards discussed below also established, in effect, a minimum 2% tangible capital standard, a 4% leverage ratio standard (3% for institutions receiving the highest rating on the CAMELS examination rating system) and, together with the risk-based capital standard itself, a 4% Tier 1 risk-based capital standard. The OTS regulations also require that, in meeting the tangible, leverage and risk-based capital standards, institutions must generally deduct investments in and loans to subsidiaries engaged in activities as principal that are not permissible for a national bank.

In determining compliance with the risk-based capital requirement, savings institutions must compute its risk-weighted assets by multiplying its assets, including certain off-balance sheet assets, recourse obligations, residual interests and direct credit substitutes, by risk-weight factors ranging from 0% for cash and obligations of the United States Government or its agencies to 100% for consumer and commercial loans, as assigned by the OTS capital regulation based on the risks believed inherent in the type of asset.

Core (Tier 1) capital is defined as common stockholders equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles (other than certain mortgage servicing rights) and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

The OTS also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution s capital level is or may become inadequate in light of the particular circumstances. At December 31, 2005, the Bank exceeded each of these capital requirements.

Prompt Corrective Regulatory Action. The OTS is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution s degree of undercapitalization. Generally, a savings institution that has a ratio of total capital to risk weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be undercapitalized. A savings institution that has a total risk-based capital ratio less

than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be significantly undercapitalized and a savings institution that has a tangible capital to assets ratio equal to or less than 2% is deemed to be critically undercapitalized. Subject to a narrow exception, the OTS is required to appoint a receiver or conservator within specified time frames for an institution that is critically undercapitalized. An institution must file a capital restoration plan with the OTS within 45 days of the date it receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Compliance with the plan must be guaranteed by any parent holding company. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. Significantly undercapitalized and critically undercapitalized institutions are subject to more extensive mandatory regulatory actions. The OTS could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors.

Loans to One Borrower. Federal law provides that savings institutions are generally subject to the limits on loans to one borrower applicable to national banks. Generally, a savings institution may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if secured by specified readily-marketable collateral. *See Item 1. Business. Lending Activities Loans to One Borrower.*

Standards for Safety and Soundness. The federal banking agencies have adopted Interagency Guidelines, which set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the OTS determines that a savings institution fails to meet any standard prescribed by the guidelines, the OTS may require the institution to submit an acceptable plan to achieve compliance with the standard. The Bank has not received any notice from the OTS that it has failed to meet any standard prescribed by the guidelines.

Limitation on Capital Distributions. OTS regulations impose limitations upon all capital distributions by a savings institution, including cash dividends, payments to repurchase its shares and payments to shareholders of another institution in a cash-out merger. Under the regulations, an application to and the prior approval of the OTS is required before any capital distribution if the institution does not meet the criteria for expedited treatment of applications under OTS regulations (*i.e.*, generally, examination and Community Reinvestment Act ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the OTS. If an application is not required, the institution must still provide prior notice to the OTS of the capital distribution if, like the Bank, it is a subsidiary of a holding company. If the Bank s capital were ever to fall below its regulatory requirements or the OTS notified it that it was in need of increased supervision, its ability to make capital distributions could be restricted. In addition, the OTS could prohibit a proposed capital distribution that would otherwise be permitted by the regulation, if the agency determines that such distribution would constitute an unsafe or unsound practice.

Qualified Thrift Lender Test. Federal law requires savings institutions to meet a qualified thrift lender test. Under the test, a savings association is required to either qualify as a domestic building and loan association under the Internal Revenue Code or maintain at least 65% of its portfolio assets in certain qualified thrift investments (primarily residential mortgages and related investments, including certain mortgage-backed securities) in at least nine months out of each twelve-month period. Portfolio assets represent, in general, total assets less the sum of:

specified liquid assets up to 20% of total assets;

goodwill and other intangible assets; and

the value of property used to conduct business

A savings institution that fails the qualified thrift lender test is subject to certain operating restrictions and may be required to convert to a bank charter. Recent legislation has expanded the extent to which education loans, credit card loans and small business loans may be considered qualified thrift investments. As of December 31, 2005, the Bank maintained 76.03% of its portfolio assets in qualified thrift investments and, therefore, met the qualified thrift lender test.

Transactions with Related Parties. Federal law limits the Bank s authority to lend to, and engage in certain other transactions with (collectively, covered transactions), affiliates (*e.g*., any company that controls or is under common control with an institution, including the Company, SI Bancorp, MHC and their non-savings institution subsidiaries). The aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings institution s capital and surplus. Loans and other specified transactions with affiliates are required to be secured by collateral in an amount and of a type described in federal law. The purchase of low quality assets from affiliates is generally prohibited. Transactions with affiliates must be on terms and under circumstances that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings institution may purchase the securities of any affiliate other than a subsidiary.

The Sarbanes-Oxley Act of 2002 generally prohibits a company from making loans to its executive officers and directors. However, that act contains a specific exception for loans by a depository institution to its executive officers and directors in compliance with federal banking laws. Under such laws, the Bank s authority to extend credit to executive officers, directors and 10% shareholders (insiders), as well as entities in which such persons control, is limited. The law restricts both the individual and aggregate amount of loans the Bank may make to insiders based, in part, on the Bank s capital position and requires certain board approval procedures to be followed. Such loans must be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. In addition, loans made to a director or executive officer in an amount that, when aggregated with the amount of all other loans to the person and his or her related interest, are in excess of the greater of $25,000, or 5% of the Bank s capital and surplus, and in any event any loans totaling $500,000 or more, must be approved in advance by a majority of the disinterested members of the Board of Directors.

Enforcement. The OTS has primary enforcement responsibility over federal savings institutions and has the authority to bring actions against the institution and all institution-affiliated parties, including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order for removal of officers and/or directors to institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to $25,000 per day, or even $1.0 million per day in especially egregious cases. The FDIC has authority to recommend to the Director of the OTS that enforcement action be taken with respect to a particular savings institution. If action is not taken by the Director, the FDIC has authority to take such action under certain circumstances. Federal law also establishes criminal penalties for certain violations.

Assessments. Federal savings banks are required to pay assessments to the OTS to fund its operations. The general assessments, paid on a semi-annual basis, are based upon the savings institution s total assets, including consolidated subsidiaries, as reported in the institution s latest quarterly thrift financial report. The OTS assessments paid by the Bank for 2005 were $137,000.

Insurance of Deposit Accounts. The Bank is a member of the Bank Insurance Fund. The FDIC maintains a risk-based assessment system by which institutions are assigned to one of three categories based on their capitalization and one of three subcategories based on examination ratings and other supervisory information. An institution s assessment rate depends upon the categories to which it is assigned. Assessment rates for Bank Insurance Fund member institutions are determined semi-annually by the FDIC and currently range from zero basis points of assessable deposits for the healthiest institutions to 27 basis points of assessable deposits for the riskiest.

The Bank s assessment paid for fiscal 2005 was $63,000. The FDIC has authority to increase insurance assessments. A material increase in Bank Insurance Fund insurance premiums would likely have an adverse effect on the operating expenses and results of operation of the Bank. Management cannot predict what insurance assessment rates will be in the future.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize the predecessor to the Savings Association Insurance Fund. During the year ended December 31, 2005, Financing Corporation payments for Bank Insurance Fund members averaged 1.39 basis points of assessable deposits. At December 31, 2005, the Bank had paid all fees and assessments for deposit insurance.

The FDIC may terminate an institution s insurance of deposits upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OTS. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Federal Deposit Insurance Reform Act of 2005. The Federal Deposit Insurance Reform Act of 2005 (the Act), signed by the President on February 8, 2006, revised the laws governing the federal deposit insurance system. The Act provides for the consolidation of the Bank and Savings Association Insurance Funds into a combined Deposit Insurance Fund.

Under the Act, insurance premiums are to be determined by the FDIC based on a number of factors, primarily the risk of loss that insured institutions pose to the Deposit Insurance Fund. The legislation eliminates the current minimum 1.25% reserve ratio for the insurance funds, the mandatory assessments when the ratio fall below 1.25% and the prohibition on assessing the highest quality banks when the ratio is above 1.25%. The Act provides the FDIC with flexibility to adjust the new insurance fund s reserve ratio between 1.15% and 1.5%, depending on projected losses, economic changes and assessment rates at the end of a calendar year.

The Act increased deposit insurance coverage limits from $100,000 to $250,000 for certain types of Individual Retirement Accounts, 401(k) plans and other retirement savings accounts. While it preserved the $100,000 coverage limit for individual accounts and municipal deposits, the FDIC was furnished with the discretion to adjust all coverage levels to keep pace with inflation beginning in 2010. Also, institutions that become undercapitalized will be prohibited from accepting certain employee benefit plan deposits.

The consolidation of the Bank Insurance Fund and Savings Association Insurance Fund must occur no later than the first day of the calendar quarter that begins 90 days after the date of the Act s enactment, *i.e.*, July 1, 2006. The Act also states that the FDIC must promulgate final regulations implementing the remainder of its provisions not later than 270 days after its enactment. At this time, management cannot predict the effect, if any, that the Act will have on insurance premiums paid by the Bank.

Federal Home Loan Bank System. The Bank is a member of the Federal Home Loan Bank System, which consists of twelve regional Federal Home Loan Banks. The FHLB provides a central credit facility primarily for member institutions. The Bank, as a member of the FHLB, is required to acquire and hold shares of capital stock in FHLB. The Bank was in compliance with this requirement with an investment in FHLB at December 31, 2005 of $5.6 million.

The Federal Home Loan Banks are required to provide funds for the resolution of insolvent thrifts in the late 1980s and to contribute funds for affordable housing programs. These requirements could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and could also result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future FHLB advances increased, the Company s net interest income would be negatively impacted.

Community Reinvestment Act. Under the Community Reinvestment Act, as implemented by OTS regulations, a savings association has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The Community Reinvestment Act does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the Community Reinvestment Act. The Community Reinvestment Act requires the OTS, in connection with its examination of a savings association, to assess the institution s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution.

The Community Reinvestment Act requires public disclosure of an institution s rating and requires the OTS to provide a written evaluation of an association s Community Reinvestment Act performance utilizing a four-tiered descriptive rating system.

The Bank received an outstanding rating, which is the highest possible rating, as a result of its most recent Community Reinvestment Act assessment.

Federal Reserve System. The Federal Reserve Board regulations require savings institutions to maintain noninterest earning reserves against their transaction accounts (primarily Negotiable Order of Withdrawal (NOW) and regular checking accounts). The regulations generally provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including $48.3 million; a 10% reserve ratio is applied above $48.3 million. The first $7.8 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempted from the reserve requirements. The amounts are adjusted annually. The Bank complies with the foregoing requirements.

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Holding Company Regulation

General. The Company and SI Bancorp, MHC are savings and loan holding companies within the meaning of federal law. As such, they are registered with the OTS and are subject to OTS regulations, examinations, supervision, reporting requirements and regulations concerning corporate governance and activities. In addition, the OTS has enforcement authority over the Company, SI Bancorp, MHC and their non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the Bank.

Restrictions Applicable to Mutual Holding Companies. According to federal law and OTS regulations, a mutual holding company, such as SI Bancorp, MHC, may generally engage in the following activities: (1) investing in the stock of a bank; (2) acquiring a mutual association through the merger of such association into a bank subsidiary of such holding company or an interim bank subsidiary of such holding company; (3) merging with or acquiring another holding company, one of whose subsidiaries is a bank; (4) investing in a corporation, the capital stock of which is available for purchase by a savings association under federal law or under the law of any state where the subsidiary savings association or associations share their home offices; (5) furnishing or performing management services for a savings association subsidiary of such company; (6) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (7) holding or managing properties used or occupied by a savings association subsidiary of such company properties used or occupied by a savings association subsidiary of such company; (8) acting as trustee under deeds of trust; (9) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act, unless the OTS, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987; and (10) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the OTS.

The Gramm-Leach Bliley Act of 1999 was designed to modernize the regulation of the financial services industry by expanding the ability of bank holding companies to affiliate with other types of financial services companies such as insurance companies and investment banking companies. The legislation also expanded the activities permitted for mutual savings and loan holding companies to also include any activity permitted a financial holding company under the legislation, including a broad array of insurance and securities activities.

Federal law prohibits a savings and loan holding company, including a federal mutual holding company, from directly or indirectly, or through one or more subsidiaries, acquiring more than 5% of the voting stock of another savings institution, or its holding company, without prior written approval of the OTS. Federal law also prohibits a savings and loan holding company from acquiring more than 5% of a company engaged in activities other than those authorized for savings and loan holding companies by federal law; or acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating applications by holding companies to acquire savings institutions, the OTS must consider the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the insurance funds, the convenience and needs of the community and competitive factors.

The OTS is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, except: (1) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (2) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

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If the savings institution subsidiary of a savings and loan holding company fails to meet the qualified thrift lender test, the holding company must register with the Federal Reserve Board as a bank holding company within one year of the savings institution s failure to so qualify.

Although savings and loan holding companies are not currently subject to regulatory capital requirements or specific restrictions on the payment of dividends or other capital distributions, federal regulations do prescribe such restrictions on subsidiary savings institutions as described below. The Bank must notify the OTS 30 days before declaring any dividend. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the OTS and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

Stock Holding Company Subsidiary Regulation. The OTS has adopted regulations governing the two-tier mutual holding company form of organization and subsidiary stock holding companies that are controlled by mutual holding companies. The Company has adopted this form of organization. The Company is the stock holding company subsidiary of SI Bancorp, MHC. The Company is permitted to engage in activities that are permitted for SI Bancorp, MHC subject to the same restrictions and conditions.

Waivers of Dividends by SI Bancorp, MHC. OTS regulations require SI Bancorp, MHC to notify the OTS if it proposes to waive receipt of dividends from the Company. The OTS reviews dividend waiver notices on a case-by-case basis, and, in general, does not object to any such waiver if: (i) the waiver would not be detrimental to the safe and sound operating of the savings association subsidiary; and (ii) the mutual holding company s Board of Directors determines that such waiver is consistent with such directors fiduciary duties to the mutual holding company s members.

Acquisition of Control. Under the federal Change in Bank Control Act, a notice must be submitted to the OTS if any person (including a company), or group acting in concert, seeks to acquire control of a savings and loan holding company or savings association. An acquisition of control can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the OTS. Under the Change in Bank Control Act, the OTS has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 implemented legislative reforms intended to address corporate and accounting fraud. The Sarbanes-Oxley Act restricts the scope of services that may be provided by accounting firms to their public company audit clients and any non-audit services being provided to a public company audit client will require pre-approval by the company s audit committee. In addition, the Sarbanes-Oxley Act requires chief executive officers and chief financial officers, or their equivalents, to certify to the accuracy of periodic reports filed with the Securities and Exchange Commission, subject to civil and criminal penalties if they knowingly or willingly violate this certification requirement.

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Under the Sarbanes-Oxley Act, bonuses issued to top executives before restatement of a company s financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from insider trading during retirement plan blackout periods and loans to company executives (other than loans by financial institutions permitted by federal rules and regulations) are restricted. The legislation accelerates the time frame for disclosures by public companies of changes in ownership in a company s securities by directors and executive officers.

The Sarbanes-Oxley Act also increases the oversight of, and codifies certain requirements relating to audit committees of public companies and how they interact with the company s registered public accounting firm. Among other requirements, companies must disclose whether at least one member of the audit committee is a financial expert (as such term is defined by the Securities and Exchange Commission) and if not, why not. Although the Company anticipates that it will incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on the Company s results of operations or financial condition.

Privacy Requirements of the Gramm-Leach Bliley Act of 1999

The Gramm-Leach-Bliley Act of 1999 (the GLBA) provided for sweeping financial modernization for commercial banks, savings banks, securities firms, insurance companies and other financial institutions operating in the United States. Among other provisions, the GLBA places limitations on the sharing of consumer financial information with unaffiliated third parties. Specifically, the GLBA requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution s privacy policy and provide such customers the opportunity to opt out of the sharing of personal financial information with unaffiliated third parties.

Anti-Money Laundering and the USA Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (referred to as the USA PATRIOT Act) significantly expands the responsibilities of financial institutions, including savings and loan associations, in preventing the use of the U.S. financial system to fund terrorist activities. Title III of the USA PATRIOT Act provides for a significant overhaul of the U.S. anti-money laundering regime. Among other provisions, it requires financial institutions operating in the United States to develop new anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control Regulations.

Other Regulations

Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank s loan operations are also subject to federal laws applicable to credit transactions, such as the:

Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;

Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and

Rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The deposit operations of the Bank also are subject to the:

Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

Electronic Funds Transfer Act and Regulation E promulgated thereunder, which governs automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services; and

Check Clearing for the 21st Century Act (also known as Check 21), which gives substitute checks, such as digital check images and copies made from that image, the same legal standing as the original paper check.

Federal Income Taxation

General. The Company reports its income on a calendar year basis using the accrual method of accounting. The federal income tax laws apply to the Company in the same manner as to other corporations with some exceptions, including particularly the Bank s reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Company and its subsidiaries. The Company s federal income tax returns have been either audited or closed under the statute of limitations through tax year 2001. For its 2005 year, the Company s maximum federal income tax rate was 34%.

Bad Debt Reserves. For fiscal years beginning before June 30, 1996, thrift institutions that qualified under certain definitional tests and other conditions of the Internal Revenue Code were permitted to use certain favorable provisions to calculate their deductions from taxable income for annual additions to their bad debt reserve. A reserve could be established for bad debts on qualifying real property loans, generally secured by interests in real property improved or to be improved, under the percentage of taxable income method or the experience method. The reserve for nonqualifying loans was computed using the experience method. Federal legislation enacted in 1996 repealed the reserve method of accounting for bad debts for institutions with assets in excess of $500.0 million and the percentage of taxable income method for all institutions for tax years beginning after 1995 and required savings institutions to recapture or take into income certain portions of their accumulated bad debt reserves. However, those tax bad debt reserves accumulated prior to 1988 (Base Year Reserves) were not required to be recaptured unless the institution failed certain tests. Approximately $3.7 million of the Bank s accumulated tax-based bad debt reserves would not be recaptured into taxable income unless it makes a non-dividend distribution to the Company as described below.

Distributions. If the Bank makes non-dividend distributions to the Company, the distributions will be considered to have been made from the Bank s unrecaptured tax bad debt reserves, including the balance of its Base Year Reserves as of December 31, 1987, to the extent of the non-dividend distributions, and then from the Bank s supplemental reserve for losses on loans, to the extent of those reserves, and an amount based on the amount distributed, but not more than the amount of those reserves, will be included in the Bank s taxable income. Non-dividend distributions include distributions in excess of the Bank s current and accumulated earnings and profits as calculated for federal income tax purposes,

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distributions in redemption of stock and distributions in partial or complete liquidation. Dividends paid out of the Bank s current or accumulated earnings and profits will not be so included in the Bank s taxable income.

The amount of additional taxable income triggered by a non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Therefore, if the Bank makes a non-dividend distribution to the Company, approximately one and one-half times the amount of the distribution not in excess of the amount of the reserves would be includable in income for federal income tax purposes, assuming a 34% federal corporate income tax rate. The Bank does not intend to pay non-dividend distributions that would result in a recapture of any portion of its bad debt reserves.

State Income Taxation

The Company and its subsidiaries are subject to the Connecticut corporation business tax. The Company and its subsidiaries are eligible to file a combined Connecticut income tax return and pay the regular corporation business tax. The Connecticut corporation business tax is based on the federal taxable income before net operating loss and special deductions of the Company and its subsidiaries and makes certain modifications to federal taxable income to arrive at Connecticut taxable income. Connecticut taxable income is multiplied by the state tax rate (7.50% for fiscal year 2005) to arrive at Connecticut income tax.

In May 1998, the State of Connecticut enacted legislation permitting the formation of passive investment company subsidiaries by financial institutions. This legislation exempts qualifying passive investment companies from the Connecticut corporation business tax and excludes dividends paid from a passive investment company from the taxable income of the parent financial institution. The Bank s formation of a passive investment company in January 1999 substantially eliminates the state income tax expense of the Company and its subsidiaries under current law. *See Item 1. Business. Subsidiary Activities SI Mortgage Company for discussion of the Bank s passive investment company.*

Executive Officers of the Registrant

Certain executive officers of the Bank also serve as executive officers of the Company. The day-to-day management duties of the executive officers of the Company and the Bank relate primarily to their duties as to the Bank. The executive officers of the Company currently are as follows:

Name	Age [(1)]	Position
Rheo A. Brouillard	51	President and Chief Executive Officer of SI Financial Group, SI Bancorp, MHC and Savings Institute Bank and Trust Company
Brian J. Hull	45	Executive Vice President, Chief Financial Officer and Treasurer of SI Financial Group, SI Bancorp, MHC and Savings Institute Bank and Trust Company
Sonia M. Dudas	55	Senior Vice President and Senior Trust Officer of Savings Institute Bank and Trust Company
Michael J. Moran	57	Senior Vice President and Senior Credit Officer of Savings Institute Bank and Trust Company
William E. Anderson, Jr.	36	Vice President and Retail Banking Officer of Savings Institute Bank and Trust Company
Laurie L. Gervais	41	Vice President and Director of Human Resources of Savings Institute Bank and Trust Company

(1) Ages presented are as of December 31, 2005.

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Biographical Information:

Rheo A. Brouillard has been the President and Chief Executive Officer of Savings Institute Bank and Trust Company, SI Bancorp, MHC and SI Financial Group since 1995, 2000 and 2004, respectively. He has been a director of the Company since 1995.

Brian J. Hull has been Executive Vice President since 2002 and Chief Financial Officer and Treasurer since he joined Savings Institute Bank and Trust Company in 1997. Mr. Hull has served as Chief Financial Officer and Treasurer of SI Bancorp, MHC and SI Financial Group since 2000 and 2004, respectively.

Sonia M. Dudas has been Senior Vice President and Senior Trust Officer since 1999. Ms. Dudas oversees wealth management services, which includes trust, investment and insurance operations since she joined Savings Institute Bank and Trust Company in 1992.

Michael J. Moran has been Senior Vice President and Senior Credit Officer since 2001. Mr. Moran joined Savings Institute Bank and Trust Company in 1995.

William E. Anderson, Jr. has been Vice President and Retail Banking Officer since 2002 and 2004, respectively. Mr. Anderson joined Savings Institute Bank and Trust Company in 1995.

Laurie L. Gervais has been Vice President and Director of Human Resources since 2003 and 2001, respectively. Ms. Gervais joined Savings Institute Bank and Trust Company in 1983.

Item 1A. Risk Factors.

Prospective investors in the Company s common stock should carefully consider the following factors.

The Company s increased emphasis on commercial lending may expose it to increased lending risks. At December 31, 2005, $178.5 million, or 34.6%, of the Company s loan portfolio consisted of commercial real estate and commercial business loans. The Company intends to continue to emphasize these types of lending. These types of loans generally expose a lender to greater risk of non-payment and loss than one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Also, many of the Company s commercial borrowers have more than one loan outstanding with the Company. Consequently, an adverse development with respect to one loan or one credit relationship can expose the Company to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan.

The Company s inability to achieve profitability on new branches may negatively impact its earnings. The Company considers its primary market area to consist of Hartford, New London, Tolland and Windham counties. However, the majority of the Company s facilities are located in and a substantial portion of the Company s business is derived from Windham county, which has a lower median household income and a higher unemployment rate than other counties in the Company s market area and the rest of Connecticut. To address this, in recent years, the Company has expanded its presence throughout its market area and intends to pursue further expansion through the establishment of additional branches in Hartford, New London, Tolland and Middlesex counties, each of which has more favorable economic conditions than Windham County. The profitability of the Company s expansion policy will depend on whether the income

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that it generates from the additional branches it establishes will offset the increased expenses resulting from operating new branches. The Company expects that it may take a period of time before new branches can become profitable, especially in areas in which it does not have an established presence. During this period, operating these new branches may negatively impact the Company s net income.

Rising interest rates may hurt the Company s profits. Interest rates were recently at historically low levels. However, since June 30, 2004, the U.S. Federal Reserve has increased its target for the federal funds rate fourteen times, from 1.00% to 4.50%. While those short-term market interest rates (which the Bank uses as a guide to price its deposits) have increased, longer-term market interest rates (which the Bank uses as a guide to price its longer-term loans) have not. This flattening of the market yield curve has had a negative impact on the Company s interest rate spread and net interest margin. If interest rates continue to rise, the Company s net interest income and the value of its assets likely would be reduced if interest paid on interest-bearing liabilities, such as deposits and borrowings, increased more quickly than interest received on interest-earning assets, such as loans and investments, which would have a negative effect on the Company s profitability.

Strong competition within the Company s market area could hurt the Company s profits and slow growth. The Company faces intense competition both in making loans and attracting deposits. This competition has made it more difficult for the Company to make new loans and at times has forced the Company to offer higher deposit rates. Price competition for loans and deposits might result in the Company earning less on its loans and paying more on its deposits, which reduces net interest income. As of June 30, 2005, the Company held approximately 0.82% of the deposits in Hartford, New London, Tolland and Windham counties in Connecticut, which represented the 15th market share of deposits out of 35 financial institutions in these counties. Some of the institutions with which the Company competes have substantially greater resources and lending limits than the Company has and may offer services that the Company does not provide. The Company expects competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. The Company s profitability depends upon its continued ability to compete successfully in its market area.

The trading history of the Company s common stock is characterized by low trading volume. The Company s common stock may be subject to sudden decreases due to the volatility of the price of the Company s common stock. The Company s common stock trades on The Nasdaq National Market. Over the past 50 days, the average daily trading volume of its common stock was approximately 4,200 shares. The Company cannot predict whether a more active trading market in its common stock will occur or how liquid that market might become. A public trading market having the desired characteristics of depth, liquidity and orderliness depends upon the presence in the marketplace of willing buyers and sellers of its common stock at any given time, which presence is dependent upon the individual decisions of investors, over which we have no control.

The market price of the Company s common stock may be highly volatile and subject to wide fluctuations in response to numerous factors, including, but not limited to, the factors discussed in other risk factors and the following:

actual or anticipated fluctuations in the Company s operating results;

changes in interest rates;

changes in the legal or regulatory environment in which the Company operates;

- press releases, announcements or publicity relating to the Company or the Company s competitors or relating to trends in the Company s industry;

- changes in expectations as to the Company s future financial performance, including financial estimates or recommendations by securities analysts and investors;

- future sales of the Company s common stock;

- changes in economic conditions in the Company s marketplace, general conditions in the U.S. economy, financial markets or the banking industry; and

- other developments affecting the Company s competitors or the Company.

These factors may adversely affect the trading price of the Company s common stock, regardless of its actual operating performance, and could prevent you from selling your common stock at or above the price you desire. In addition, the stock markets, from time to time, experience extreme price and volume fluctuations that may be unrelated or disproportionate to the operating performance of companies. These broad fluctuations may adversely affect the market price of the Company s common stock, regardless of its trading performance.

Due to the time it will take to deploy the offering proceeds into higher-yielding assets, the Company expects that its return on equity initially will lag behind other, more mature publicly-held mutual holding companies. Return on equity, which equals net income divided by average equity, is a ratio used by many investors to compare the performance of a particular company with other companies. Over time, the Company intends to deploy the net proceeds from the offering, which were initially invested into investment securities, into higher-yielding assets with the goal of increasing earnings per share and book value per share, without assuming undue risk, and achieving a return on equity that is competitive with other publicly held subsidiaries of mutual holding companies. This goal could take a number of years to achieve, and the Company cannot assure you that it will be attained. Consequently, you should not expect a competitive return on equity in the near future. Failure to achieve a competitive return on equity might make an investment in the Company s common stock unattractive to some investors and might cause the Company s common stock to trade at lower prices than comparable companies with higher returns on equity.

Office of Thrift Supervision policy on remutualization transactions could prohibit acquisition of the Company, which may adversely affect its stock price. Current Office of Thrift Supervision regulations permit a mutual holding company to be acquired by a mutual institution in a remutualization transaction. The possibility of a remutualization transaction has recently resulted in a degree of takeover speculation for mutual holding companies that is reflected in the per share price of mutual holding companies common stock. However, the Office of Thrift Supervision has issued a policy statement indicating that it views remutualization transactions as raising significant issues concerning disparate treatment of minority stockholders and mutual members of the target entity and raising issues concerning the effect on the mutual members of the acquiring entity. Under certain circumstances, the Office of Thrift Supervision intends to give these issues special scrutiny and reject applications providing for the remutualization of a mutual holding company unless the applicant can clearly demonstrate that the Office of Thrift Supervision s concerns are not warranted in the particular case. Should the Office of Thrift Supervision prohibit or otherwise restrict these transactions in the future, the Company s per share stock price may be adversely affected.

SI Bancorp, MHC s majority control of the Company s common stock enables it to exercise voting control over most matters put to a vote of shareholders, including preventing a sale, a merger or a second-step conversion transaction. SI Bancorp, MHC owns a majority of the Company s common stock and, through its Board of Directors, is able to exercise voting control over most matters put to a vote of

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shareholders. The same directors and officers who manage the Company and the Bank also manage SI Bancorp, MHC. As a federally-chartered mutual holding company, the Board of Directors of SI Bancorp, MHC must ensure that the interests of depositors of the Bank are represented and considered in matters put to a vote of shareholders of the Company. Therefore, the votes cast by SI Bancorp, MHC may not be in your personal best interests as a shareholder. For example, SI Bancorp, MHC may exercise its voting control to prevent a sale or merger transaction in which shareholders could receive a premium for their shares or to defeat a shareholder nominee for election to the Board of Directors of the Company. In addition, SI Bancorp, MHC may exercise its voting control to prevent a second-step conversion transaction. Preventing a second-step conversion transaction may result in a lower value of the Company s stock price than otherwise could be achieved as, historically, fully-converted institutions trade at higher multiples than mutual holding companies. The matters as to which shareholders, other than SI Bancorp, MHC, will be able to exercise voting control are limited.

The Company operates in a highly regulated environment and it may be adversely affected by changes in laws and regulations. The Company is subject to extensive regulation, supervision and examination by the Office of Thrift Supervision, the Company s chartering authority and the Federal Deposit Insurance Corporation, as insurer of the Bank s deposits. SI Bancorp, MHC, the Company and the Bank are all subject to regulation and supervision by the Office of Thrift Supervision. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the insurance fund and depositors. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on the Company s operations, the classification of its assets and determination of the level of the Bank s allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on the Company s operations.

The Company is subject to security and operational risks relating to use of its technology that could damage its reputation and business. Security breaches in the Company s internet banking activities could expose it to possible liability and damage its reputation. Any compromise of the Company s security also could deter customers from using its internet banking services that involve the transmission of confidential information. The Company relies on standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect its systems from compromises or breaches of its security measures that could result in damage to its reputation and business. Additionally, the Company outsources its data processing to a third party. If the Company s third party provider encounters difficulties or if the Company has difficulty in communicating with such third party, it will significantly affect the Company s ability to adequately process and account for customer transactions, which would significantly affect its business operations.

Item 1B. Unresolved Staff Comments.

None.

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Item 2. Properties.

The Bank conducts its business through its main office and branch offices. The following table sets forth certain information relating to these facilities as of December 31, 2005.

Location	Year Opened	Square Footage	Date of Lease Expiration	Own/ Lease	Net Book Value as of December 31, 2005 *(Dollars in thousands)*
Main Office:					
803 Main Street Willimantic, Connecticut 06226	1870	26,210		Own	$ 1,951
Branch Offices:					
115 Main Street Hebron, Connecticut 06248	1974	2,400		Own	499
554 Exeter Road, Route 207 Lebanon, Connecticut 06249	1978	2,128		Own	245
9 Proulx Street Brooklyn, Connecticut 06234	1990	1,538	2010	Lease	200
85 Freshwater Boulevard Enfield, Connecticut 06082	1992	4,365	2007[1]	Lease	15
Bell Park Plaza, 563 Hartford Pike Dayville, Connecticut 06241	1996	2,460	2006[1]	Lease	5
971 Poquonnock Road Groton, Connecticut 06340	1997	3,373	2007[2]	Lease	10
Big Y, 224 Salem Turnpike Norwich, Connecticut 06360	1998	575	2008[2]	Lease	
344 Prospect Street Moosup, Connecticut 06354	1998	2,160	2008[2]	Lease	261
Shaw s, 60 Cantor Drive Willimantic, Connecticut 06226	1998	421	2010[1]	Lease	
180 Westminster Road, Route 14 Canterbury, Connecticut 06331	1998	1,781	2008[2]	Lease	27
Walmart, 474 Boston Post Road North Windham, Connecticut 06256	2000	540	2010[1]	Lease	62
Walmart, Lisbon Landing, 180 River Road Lisbon, Connecticut 06351	2001	656	2006[2]	Lease	105

East Brook Mall, 95 Storrs Road Mansfield Center, Connecticut 06250	2002	2,325	2022[3]	Lease	509
1000 Sullivan Avenue South Windsor, Connecticut 06074	2005	2,955	2025[2]	Lease	21
Mystic Plaza, 80 Stonington Road Stonington, Connecticut 06378	2005	3,436	2014[3]	Lease	395
Meetinghouse Commons 200 Merrow Road, Route 195 Tolland, Connecticut 06084	2005	2,870	2015[2]	Lease	283
Other Properties:					
66 Routes 32 and 87 Franklin, Connecticut 06254	1983	2,380		Own	244
530 Stonington Road, Route 1 Stonington, Connecticut 06378	1987	1,960	2006[1]	Lease[4]	
7 Ledgebrook Drive Mansfield, Connecticut 06250	1990	4,554	2007	Lease[6]	9
779 Main Street Willimantic, Connecticut 06226	1999	8,182		Own[7]	213
579 North Windham Road North Windham, CT 06256	2005	10,000	2010[5]	Lease[8]	421
80 West Street Rutland, Vermont 05701	2005	7,496	2011[1]	Lease[6]	
Total:					$ 5,475

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(1) The Company has an option to renew this lease for one additional five-year period.

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(2) The Company has an option to renew this lease for two additional five-year periods.
(3) The Company has an option to renew this lease for four additional five-year periods.
(4) Premises vacated in May 2005 and branch office relocated to 80 Stonington Road location. The lease terminates in July 2006.

(5) The Company has an option to renew this lease for three additional five-year periods.
(6) This facility houses trust operations.
(7) A portion of this property includes a parking lot for the main office. The remainder of this property has been leased to a subtenant under a lease that expires in December 2007. The subtenant has an option to renew this lease for three additional five-year periods.
(8) A portion of this facility is used for an employee training center.

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Item 3. Legal Proceedings.

At December 31, 2005, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company s financial condition or results of operations. Periodically, there have been various claims and lawsuits against us, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interest, claims involving the making and servicing of real property loans and other issues incident to our business. However, neither the Company nor the Bank is a party to any pending legal proceedings that management believes would have a material adverse effect on the Company s financial condition, results of operations or cash flows.

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

None.

PART II.

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

The Company s common stock is listed on the Nasdaq National Market (NASDAQ) under the trading symbol SIFI. The Company completed its initial public offering on September 30, 2004 and commenced trading on October 1, 2004. The following table sets forth the high and low sales prices of the common stock and the dividends declared per share of common stock for the periods indicated, as reported by NASDAQ. These high and low sales prices reflect inter-dealer prices, without retail mark-up, mark-downs or commissions, and may not represent actual transactions.

	Price Range		Dividends
Year Ended December 31, 2005:	**High**	**Low**	**Declared**
First Quarter	$ 12.27	$ 10.75	$ 0.03
Second Quarter	11.76	9.74	0.03
Third Quarter	12.49	11.22	0.03
Fourth Quarter	12.26	10.81	0.03

	Price Range		Dividends
Year Ended December 31, 2004:	**High**	**Low**	**Declared**
First Quarter	N/A	N/A	N/A
Second Quarter	N/A	N/A	N/A
Third Quarter	N/A	N/A	N/A
Fourth Quarter	$ 12.40	$ 10.70	N/A

The continued payment of dividends is dependent upon the Company s debt and equity structure, earnings, financial condition, need for capital in connection with possible future acquisitions and other factors, including economic conditions, regulatory restrictions and tax considerations. The Company cannot guarantee that it will pay dividends or that, if paid, that it will not reduce or eliminate dividends in the future. *See Item 1. Business. Regulation and Supervision Limitation on Capital Distributions and Note 17 in the Notes to the Consolidated Financial Statements for more information relating to restrictions on dividends.*

As of December 31, 2005, there were 12,551,186 shares of common stock outstanding, of which 7,286,975 were held by SI Bancorp, MHC, and were held by approximately 1,005 holders of record, including SI Bancorp, MHC.

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The following table provides certain information with regard to shares repurchased by the Company in the fourth quarter of 2005.

Period	Total Number of Shares Purchased [1]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs
October 1, 2005 through October 31, 2005		$		
November 1, 2005 through November 30, 2005				628,000
December 1, 2005 through December 31, 2005	12,564	11.74	12,564	615,436
Total	12,564	$ 11.74	12,564	615,436

(1) On November 23, 2005, the Company announced that the Board of Directors had approved a stock repurchase program authorizing the Company to repurchase up to 628,000 shares of the Company s common stock. The repurchase program will continue until it is completed or terminated by the Board of Directors.

Item 6. Selected Financial Data.

The Company has derived the following selected consolidated financial and other data in part from its Consolidated Financial Statements and Notes appearing elsewhere in this Form 10-K.

Selected Financial Condition Data:	At December 31,				
(Dollars in Thousands)	**2005**	**2004**	**2003**	**2002**	**2001**
Total assets	$ 691,868	$ 624,649	$ 518,141	$ 484,944	$ 427,522
Cash and cash equivalents	25,946	30,775	29,577	37,517	30,077
Securities held to maturity			1,728	9,463	13,197
Securities available for sale	120,019	120,557	77,693	87,914	78,697
Loans receivable, net	513,775	447,957	386,924	334,598	293,111
Deposits [1]	512,282	460,480	417,311	398,315	363,029
Federal Home Loan Bank advances	87,929	72,674	57,168	43,918	35,183
Junior subordinated debt owed to unconsolidated trust	7,217	7,217	7,217	7,217	
Other borrowings				1,951	
Total stockholders equity	80,043	80,809	34,099	31,408	27,816

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Selected Operating Data: *(Dollars in Thousands, Except Per Share Data)*	Years Ended December 31, 2005	2004	2003	2002	2001
Interest and dividend income	$ 33,905	$ 28,603	$ 27,930	$ 28,330	$ 27,607
Interest expense	12,131	9,400	9,346	11,014	13,154
Net interest and dividend income	21,774	19,203	18,584	17,316	14,453
Provision for loan losses	410	550	1,602	537	440
Net interest and dividend income after provision for loan losses	21,364	18,653	16,982	16,779	14,013
Noninterest income	6,310	4,185	4,722	3,284	3,362
Noninterest expenses	22,588	21,031	16,606	15,394	14,470
Income before income tax provision	5,086	1,807	5,098	4,669	2,905
Income tax provision	1,689	519	1,713	1,587	989
Net income	$ 3,397	$ 1,288	$ 3,385	$ 3,082	$ 1,916
Basic earnings per share	$ 0.28	N/A	N/A	N/A	N/A
Diluted earnings per share	$ 0.28	N/A	N/A	N/A	N/A

Selected Operating Ratios:	At or For the Years Ended December 31, 2005	2004	2003	2002	2001
Performance Ratios:					
Return on average assets	0.52%	0.23%	0.67%	0.68%	0.48%
Return on average equity	4.19	2.77	10.34	10.46	7.19
Interest rate spread (2)	3.19	3.41	3.81	3.79	3.48
Net interest margin (3)	3.56	3.64	3.98	4.04	3.86
Noninterest expense to average assets (4)	3.47	3.71	3.30	3.39	3.64
Dividend payout ratio (5)	42.86	N/A	N/A	N/A	N/A
Efficiency ratio (6)	80.60	89.29	71.62	73.80	81.91
Average interest-earning assets to average interest-bearing liabilities	118.38	112.93	108.70	110.03	110.76
Average equity to average assets	12.45	8.21	6.51	6.49	6.71
Regulatory Capital Ratios:					
Total risk-based capital ratio	16.79	18.03	12.45	12.12	11.51
Tier 1 risk-based capital ratio	15.87	17.12	11.50	11.00	10.38
Tier 1 capital ratio (7)	9.31	9.99	6.81	6.46	6.29
Tangible equity ratio	9.31	9.99	N/A	N/A	N/A
Asset Quality Ratios:					
Allowance for loan losses as a percent of total loans	0.71	0.71	0.69	0.91	0.97
Allowance for loan losses as a percent of nonperforming loans	1529.58	338.98	207.57	166.50	130.64
Net recoveries (charge-offs) to average outstanding loans during the year	0.01	0.01	0.55	0.11	0.07

(1) Includes mortgagors and investors escrow accounts.

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(2) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.
(3) Represents net interest income as a percent of average interest-earning assets.
(4) The noninterest expense to average assets ratio, excluding the effect of the contribution expense to SI Financial Group Foundation, was 3.27% for the year ended December 31, 2004.
(5) Dividends declared per share divided by basic net income per common share. Dividends paid on shares held by SI Bancorp, MHC are waived and are excluded from this ratio. Comparable figures for 2004, 2003, 2002 and 2001 are not available.
(6) Represents noninterest expense divided by the sum of net interest income and noninterest income, excluding gains or losses on the sale of securities. The efficiency ratio, excluding the effect of the contribution to SI Financial Group Foundation, was 78.62% for the year ended December 31, 2004.
(7) Represents tier 1 capital to total assets as required by OTS regulations at December 31, 2005 and 2004 and tier 1 capital to total average assets at December 31, 2003, 2002 and 2001 as required by FDIC regulations.

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

General

The Company s results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on the Company s interest-earning assets, such as loans and investments, and the interest expense on its interest-bearing liabilities, such as deposits and borrowings. The Company also generates noninterest income such as gains on securities and loan sales, fees from deposit and trust and investment management services, insurance commissions and other fees. The Company s noninterest expenses primarily consist of employee compensation and benefits, occupancy, computer services, furniture and equipment, outside professional services, electronic banking fees, marketing and other general and administrative expenses. The Company s results of operations are also significantly affected by general economic and competitive conditions, particularly changes in market interest rates, governmental policies and actions of regulatory agencies.

The following analysis discusses changes in the financial condition as of December 31, 2005 and 2004 and the results of operations for the years ended December 31, 2005, 2004 and 2003 and should be read in conjunction with the Company s Consolidated Financial Statements and the Notes thereto, appearing in Part IV, Item 15 of this document.

Management Strategy

The Company s mission is to operate and grow a profitable community-oriented financial institution. The Company plans to achieve this by continuing its strategy of:

- offering a full range of financial services;
- expanding the branch network into new market areas;
- pursuing opportunities to increase commercial lending in the Bank s market area;
- applying conservative underwriting practices to maintain the high quality of the Bank s loan portfolio;
- managing net interest margin and net interest spread by seeking to increase lending levels;

managing investment and borrowing portfolios to provide liquidity, enhance income and manage interest rate risk; and

increasing deposits by continuing to offer exceptional customer service and emphasizing the Bank s commercial deposit offerings.
Offering a full range of financial services. The Bank has a long tradition of focusing on the needs of consumers and small and medium-sized businesses in the community and being an active corporate citizen. The Bank delivers personalized service and responds with flexibility to customers needs. The Bank believes its community orientation is attractive to its customers and distinguishes it from the large regional banks that operate in its market area and it intends to maintain this focus as it grows. In this context, the Bank is striving to become a true financial services company offering its customers one-stop shopping for all of their financial needs through banking, investments, insurance and trust products and services. The Bank hopes that its broad array of product offerings will deepen its relationships with its current customers and entice new customers to begin banking with them, ultimately increasing fee income and profitability.

The Company s purchase of the net assets of SI Trust Servicing in November 2005, a third-party provider of trust outsourcing services for community banks, expands the products offered by the Bank, and offers a trust service to other community banks, while presenting significant growth opportunities for the Company s wealth management business and earnings.

Expand branch network into new market areas. Since 2000, the Bank has opened a new branch office in each of North Windham, Lisbon, Mansfield Center, Tolland and South Windsor, Connecticut. The Bank intends to continue to pursue expansion in Hartford, New London, Tolland and Windham Counties in future years, whether through de novo branching or acquisition, and may consider exploring expansion opportunities in Middlesex County. The Bank anticipates the opening of its 18th office in East Lyme and its 19th office in Gales Ferry during the first and third quarters of 2006, respectively.

Pursue opportunities to increase commercial lending. Commercial real estate and commercial business loans increased $37.1 million and $17.2 million for the years ended December 31, 2005 and 2004, respectively, and at December 31, 2005 comprised approximately 34.6% of total loans. There are many multi-family and commercial properties and businesses located in the Bank s market area and the larger lending relationships associated with these commercial opportunities may be pursued, while continuing to originate any such loans in accordance with what the Bank believes are conservative underwriting guidelines. Toward this end, the Bank has hired additional seasoned commercial lenders and offered new products to increase the Bank s ability to serve the market.

Apply conservative underwriting practices and maintain high quality loan portfolio. The Bank believes that high asset quality is a key to long-term financial success. The Bank has sought to maintain a high level of asset quality and moderate credit risk by using underwriting standards which it believes are conservative, and by diligent monitoring and collection efforts. Evidence of the Bank s quality loan portfolio is the decrease in nonperforming loans from $944,000 at December 31, 2004 to $240,000 at December 31, 2005. At December 31, 2005, nonperforming loans were only 0.05% of total loan portfolio and 0.08% of total assets. Although the Bank intends to increase its multi-family and commercial real estate and commercial business lending, it intends to continue its philosophy of managing large loan exposures through a conservative approach to lending.

Manage net interest margin and net interest spread. The Company intends to continue to manage its net interest margin and net interest spread by seeking to increase lending levels. Loans secured by multi-family and commercial real estate are generally larger and involve a greater degree of risk than one-to four-family residential mortgage loans. Consequently, multi-family and commercial real estate loans typically have higher yields, which increase the Company s net interest margin and net interest spread.

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Manage investment and borrowing portfolios. The Company s liquidity, income and interest rate risk are affected by the management of its investment and borrowing portfolios. The Company has and may continue to leverage the additional capital from the offering by borrowing funds from the Federal Home Loan Bank and investing the funds in loans and investment securities in a manner consistent with its current portfolio. This leverage strategy, if implemented and assuming favorable market conditions, will provide additional liquidity, enhance earnings and help to manage interest rate risk.

Increase deposits. The Company s primary source of funds is retail deposit accounts. Annually, deposits have continued to increase primarily due to competitive interest rates and the movement of customer funds out of riskier investments, including the stock market. The Company intends to continue to increase its deposits by continuing to offer exceptional customer service and by focusing on increasing its commercial deposits from small and medium-sized businesses through additional business banking products.

Critical Accounting Policies

The Company considers accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. The Company considers the allowance for loan losses and the impairment of long-lived assets to be its critical accounting policies.

Allowance for Loan Losses. Determining the amount of allowance for loan losses necessarily involves a high degree of judgment. Management reviews the level of the allowance on a monthly basis and establishes the provision for loan losses based on the size and the composition of the loan portfolio, delinquency levels, loss experience, economic conditions, and other factors related to the collectibility of the loan portfolio. The level of the allowance for loan losses fluctuates primarily due to changes in the size and composition of the loan portfolio and in the level of nonperforming loans, classified assets and charge-offs. A portion of the allowance is established by segregating the loans by loan category and assigning allocation percentages based on our historical loss experience and delinquency trends. The applied loss factors are re-evaluated annually to ensure their relevance in the current real estate environment. Accordingly, increases in the size of the loan portfolio and the increased emphasis on commercial real estate and commercial business loans, which carry a higher degree of risk of default and, thus, a higher allocation percentage, increases the allowance. Additionally, a portion of the allowance is established based on the level of specific nonperforming loans, classified assets or charged-off loans.

Although the Bank believes that it uses the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, the OTS, as an integral part of its examination process, periodically reviews the allowance for loan losses. Such agency may require the Bank to recognize adjustments to the allowance based on its judgments about information available to it at the time of its examination. *See Part I. Item 1. Business. Lending Activities Allowance for Loan Losses and Notes 1 and 4 in the Notes to the Consolidated Financial Statements for additional information.*

Impairment of Long-Lived Assets. The Company is required to record certain assets it has acquired, including identifiable intangible assets such as core deposit intangibles, goodwill and certain liabilities that it assumed at fair value, which may involve making estimates based on third party valuations, such as appraisals, or internal valuations based on discounted cash flow analyses or other valuation

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techniques. Further, long-lived assets, including intangible assets and premises and equipment, that are held and used by us, are presumed to have a useful life. The determination of the useful lives of intangible assets is subjective, as is the appropriate amortization period for such intangible and long-lived assets. Additionally, long-lived assets are reviewed for impairment annually at a minimum or whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If impairment is indicated by that review, the asset is written down to its estimated fair value through a charge to noninterest expense. Testing for impairment is a subjective process, the application of which could result in different evaluations of impairment. *See Notes 1, 4, 6 and 7 in the Notes to the Consolidated Financial Statements for additional information.*

Analysis of Net Interest Income

Average Balance Sheet. The following table presents information regarding average balances of assets and liabilities, the total dollar amounts of interest and dividend income from average interest-earning assets, the total dollar amounts of interest expense on average interest-bearing liabilities and the resulting average yields and costs. The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of this table, average balances have been calculated using average daily balances.

	For the Years Ended December 31,								
	2005			2004			2003		
(Dollars in Thousands)	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate	Average Balance	Interest & Dividends	Average Yield/ Rate
ASSETS:									
INTEREST-EARNING ASSETS:									
Loans [1][2]	$ 472,010	$ 28,586	6.06%	$ 412,415	$ 24,545	5.95%	$ 360,655	$ 23,840	6.61%
Investment securities [3]	127,736	5,018	3.93	97,021	3,826	3.94	92,353	3,944	4.27
Other interest-earning assets	12,020	308	2.56	18,309	240	1.31	14,166	155	1.09
TOTAL INTEREST-EARNING ASSETS	611,766	33,912	5.54	527,745	28,611	5.42	467,174	27,939	5.98
Noninterest-earning assets	39,242			38,478			35,926		
TOTAL ASSETS	$ 651,008			$ 566,223			$ 503,100		
LIABILITIES AND EQUITY:									
INTEREST-BEARING LIABILITIES:									
Deposits:									
NOW and money market	$ 118,858	653	0.55	$ 108,678	384	0.35	$ 98,543	424	0.43
Savings [4]	92,999	854	0.92	91,721	625	0.68	87,904	666	0.76
Certificates of deposit	218,102	7,021	3.22	194,569	5,337	2.74	185,181	5,507	2.97
Total interest-bearing deposits	429,959	8,528	1.98	394,968	6,346	1.61	371,628	6,597	1.78
FHLB advances	79,596	3,108	3.90	65,154	2,683	4.12	49,693	2,315	4.66
Subordinated debt	7,217	495	6.86	7,217	371	5.14	7,217	360	4.99
Other borrowings							1,233	74	6.00
TOTAL INTEREST-BEARING LIABILITIES	516,772	12,131	2.35	467,339	9,400	2.01	429,771	9,346	2.17
Noninterest-bearing liabilities	53,192			52,392			40,601		

TOTAL LIABILITIES	569,964			519,731			470,372		
TOTAL STOCKHOLDERS EQUITY	81,044			46,492			32,728		
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 651,008			$ 566,223			$ 503,100		
NET INTEREST-EARNING ASSETS	$ 94,994			$ 60,406			$ 37,403		
TAX EQUIVALENT NET INTEREST INCOME [3]		21,781			19,211			18,593	
TAX EQUIVALENT INTEREST RATE SPREAD [5]			3.19%			3.41%			3.81%
TAX EQUIVALENT NET INTEREST MARGIN AS A PERCENTAGE OF INTEREST-EARNING ASSETS [6]			3.56%			3.64%			3.98%
AVERAGE INTEREST-EARNING ASSETS TO AVERAGE INTEREST-BEARING LIABILITIES			118.38%			112.93%			108.70%
LESS: TAX EQUIVALENT ADJUSTMENT [3]		(7)			(8)			(9)	
NET INTEREST INCOME		$ 21,774			$ 19,203			$ 18,584	

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[1] Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale.

(2) Loan fees are included in interest income and are immaterial.

(3) Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of 34%. The tax equivalent adjustment is deducted from tax equivalent net interest income to agree to the amounts reported in the statements of income.

(4) Includes mortgagors and investors escrow accounts.

(5) Tax equivalent net interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.

(6) Tax equivalent net interest margin represents tax equivalent net interest income divided by average interest-earning assets.

Rate/Volume Analysis. The following table sets forth the extent to which changes in interest rates and changes in volume of interest-earning assets and interest-bearing liabilities have on the Company s interest income and interest expense for the periods presented. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the rate and volume columns. For purposes of this table, changes attributable to both changes in rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

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(Dollars in Thousands)	2005 Compared to 2004 Increase (Decrease) Due To Rate	Volume	Net	2004 Compared to 2003 Increase (Decrease) Due To Rate	Volume	Net
INTEREST-EARNING ASSETS:						
Interest and Dividend Income:						
Loans [1][2]	$ 549	$ 3,492	$ 4,041	$ (2,515)	$ 3,220	$ 705
Investment securities [3]	(15)	1,207	1,192	(311)	193	(118)
Other interest-earning assets	129	(61)	68	45	40	85
TOTAL INTEREST-EARNING ASSETS	663	4,638	5,301	(2,781)	3,453	672
INTEREST-BEARING LIABILITIES:						
Interest Expense:						
Deposits [4]	1,540	642	2,182	(591)	340	(251)
FHLB advances	(145)	570	425	(292)	660	368
Subordinated debt	124		124	11		11
Other borrowings				(37)	(37)	(74)
TOTAL INTEREST-BEARING LIABILITIES	1,519	1,212	2,731	(909)	963	54
CHANGE IN NET INTEREST AND DIVIDEND INCOME [5]	$ (856)	$ 3,426	$ 2,570	$ (1,872)	$ 2,490	$ 618

(1) Amount is net of deferred loan origination fees and costs. Average balances include nonaccrual loans and loans held for sale.
(2) Loans fees are included in interest income and are immaterial.
(3) Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of 34%. The tax equivalent adjustment is deducted from tax equivalent net interest income to agree to the amounts reported in the statements of income.
(4) Includes mortgagors and investors escrow accounts.
(5) Presented on a tax equivalent basis.

Comparison of Financial Condition at December 31, 2005 and December 31, 2004

Assets. The Company s total assets increased $67.2 million, or 10.8%, to $691.9 million at December 31, 2005, as compared to $624.6 million at December 31, 2004, primarily due to increases loans receivable, and to a lesser extent, premises and equipment and FHLB stock. Net loans receivable increased $65.8 million, or 14.7%, to $513.8 million at December 31, 2005. All categories of the loan portfolio contributed to the increase in net loans receivable with commercial real estate, consumer and one- to four-family residential loans yielding the largest increases. In 2005, loan originations for commercial real estate and business loans increased 4.1% which reflects the Company s emphasis on the commercial loan market in order to enhance earnings with higher yields on loans and to diversify the loan portfolio. Consumer and residential real estate loan originations increased 5.9% and 1.8%, respectively. The increase in net loans receivable was offset by loan sales of $35.5 million. Premises and equipment, net, increased $2.3 million, or 34.2%, to $8.8 million as a result of branch expansion and property acquired from the acquisition of SI Trust Services in 2005. FHLB stock increased $1.3 million to $5.6 million at December 31, 2005, resulting from the implementation of FHLB s new capital plan and to support a higher level of FHLB borrowings.

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Liabilities. Total liabilities increased $68.0 million, or 12.5%, from December 31, 2004 to December 31, 2005 primarily as a result of increases in deposits and FHLB advances. Deposits, including mortgagors and investors escrow accounts, increased $51.8 million, or 11.3%, to $512.3 million at December 31, 2005. The Company experienced increases in interest-bearing accounts, such as certificates of deposit and NOW and money market accounts due to greater deposit volume resulting from branch expansion, competitive pricing and marketing efforts. In addition, noninterest-bearing deposits increased primarily as a result of business checking deposit volume. FHLB advances increased $15.3 million, or 21.0%, to $87.9 million at December 31, 2005. The FHLB borrowing increases were primarily fixed-rate advances with terms of two to seven years used to fund loan growth and to manage interest rate risk.

Equity. Total stockholders equity decreased $766,000 to $80.0 million at December 31, 2005. The decrease in equity was primarily attributable to the implementation of the Company s equity incentive plan at a cost of $2.5 million, an increase in net unrealized holding losses on available for sale securities aggregating $1.3 million (net of taxes), dividends declared of $590,000 and treasury share purchases of $148,000, offset by earnings of $3.4 million.

Comparison of Operating Results for the Years Ended December 31, 2005 and 2004

General. The Company recorded net income of $3.4 million for the year ended December 31, 2005, an increase of $2.1 million, compared to $1.3 million for the year ended December 31, 2004. The increase was primarily attributable to a $2.6 million increase in net interest and dividend income, a $2.1 million increase in noninterest income and a $140,000 decrease in the provision for loan losses, offset by increases of $1.6 million in noninterest expenses and $1.2 million in the provision for income taxes. The increase in net interest and dividend income in 2005 resulted primarily from an increase in average earning assets, offset by increases in the rate paid on deposit accounts and the average balance of FHLB advances. For the year ended December 31, 2004, noninterest expenses included a $2.5 million contribution of common stock to SI Financial Group Foundation, resulting in a charge to earnings of approximately $1.7 million after taxes.

Interest and Dividend Income. Total interest and dividend income increased $5.3 million, or 18.5%, for 2005. Average interest-earning assets increased $84.0 million, or 15.9%, to $611.8 million in 2005, mainly due to higher loan volume. Average loans increased $59.6 million and the rate earned on loans increased 11 basis points to 6.06% for 2005 from 5.95% for 2004. Increased volume on higher yielding commercial loans contributed to the rise in interest earned on loans for 2005. Average securities rose $30.7 million, while the yield nominally declined to 3.93% in 2005 from 3.94% in 2004.

Interest Expense. Interest expense increased $2.7 million, or 29.1%, to $12.1 million for 2005 compared to $9.4 million in 2004, primarily as a result of the rate paid on deposits. The yield on deposit accounts increased 37 basis points due to rising market interest rates and average deposits rose $35.0 million in 2005. Although the average balance remained constant, the rate paid on subordinated debt borrowings increased 172 basis points from 5.14% to 6.86%. Average FHLB advances increased $14.4 million, while the yield on FHLB borrowings declined 22 basis points to 3.90% for 2005.

Provision for Loan Losses. The Company s provision for loan losses decreased $140,000 to $410,000 in 2005 from $550,000 in 2004. The Company s conservative underwriting standards as well as a favorable real estate market have contributed to the quality of the loan portfolio. The quality of the loan portfolio is evidenced by a reduction in nonperforming loans to $240,000 from $944,000, respectively, and net recoveries from loan losses of $61,000 compared to net charge-offs of $38,000 for the years ended December 31, 2005 and 2004, respectively. Despite improved asset quality, the Company continues to monitor the impact that the rise in short-term interest rates will have on variable-rate borrowers and their ability to repay higher monthly interest payments.

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Noninterest Income. Total noninterest income increased $2.1 million, or 50.8%, to $6.3 million in 2005. The following table shows the components of noninterest income and the dollar and percentage changes from 2004 to 2005.

(Dollars in Thousands)	Years Ended December 31, 2005	2004	Change Dollars	Percent
Service fees	$ 4,262	$ 2,941	$ 1,321	44.9%
Wealth management fees	1,301	942	359	38.1
Increase in cash surrender value of BOLI	276	303	(27)	(8.9)
Net gain (loss) on sale of securities	59	(166)	225	135.5
Net gain on sale of loans	190	55	135	245.5
Other	222	110	112	101.8
TOTAL NONINTEREST INCOME	$ 6,310	$ 4,185	$ 2,125	50.8

Service fees increased primarily as a result of the Bank s courtesy overdraft protection program offered to its deposit customers, which commenced in the first quarter of 2005 and as a result of customers escalating usage of the Bank s electronic banking products. Wealth management fees, which include trust and investment services fees, rose in part due to the acquisition of SI Trust Servicing in November 2005 and a larger balance of assets under management. The Company realized net gains on the sale of securities sold in 2005 compared to realized net losses in 2004. The volume of securities sold was greater in 2005 versus 2004. Net gains on the sale of loans reflect the sale of $35.5 million of loans in 2005 compared to $15.5 million in 2004. Increases in other noninterest income include a net gain of $40,000 on the sale of former branch locations and training center and a distribution of $107,000 in a small business investment corporation carried at cost.

Noninterest Expenses. Noninterest expenses increased by $1.6 million, or 7.4%, for 2005 as compared to 2004. The following table shows the components of noninterest expenses and the dollar and percentage changes from 2004 to 2005.

(Dollars in Thousands)	Years Ended December 31, 2005	2004	Change Dollar	Percent
Salaries and employee benefits	$ 12,102	$ 9,835	$ 2,267	23.1%
Occupancy and equipment	3,830	3,465	365	10.5
Computer and electronic banking services	1,823	1,678	145	8.6
Outside professional services	1,087	815	272	33.4
Marketing and advertising	794	513	281	54.8
Supplies	449	293	156	53.2
Contribution to SI Financial Group Foundation		2,513	(2,513)	(100.0)
Other	2,503	1,919	584	30.4
TOTAL NONINTEREST EXPENSES	$ 22,588	$ 21,031	$ 1,557	7.4

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Increases in salaries, benefits and taxes reflects higher staffing levels related to branch expansion as well as the amortization of share-based compensation awards granted in 2005. The adoption of SFAS 123R during the second quarter of 2005 resulted in share-based compensation expense of $476,000, which represents the amortization of stock option and restricted stock awards over their requisite service period. In addition, the Company recorded compensation expense in connection with the employee stock ownership plan of $366,000 in 2005 compared to $93,000 in 2004. Additional facility leases, depreciation expense and other occupancy-related expenses associated with branch expansion resulted in the increase in occupancy and equipment expenses. In 2004, occupancy expense included a $337,000 impairment charge to reduce the carrying value of a former branch facility to its estimated net market value, which was ultimately sold in 2005. Electronic banking fees continue to rise as a result of greater electronic banking transactions. Increases in outside professional services, which primarily include legal and auditing services, were attributable to higher costs associated with the Company s public reporting requirements and consulting costs for assistance with Sarbanes Oxley compliance. Marketing and advertising expenses increased as a result of aggressive marketing campaigns for the Bank s products and services and promotions related to new branch openings. Other expenses were higher in 2005 mainly due to the implementation of the Bank s remote branch capture system and the greater than anticipated losses on uncollectible items. In 2004, noninterest expenses included a $2.5 million contribution of the Company s common stock to SI Financial Group Foundation in connection with the Company s initial public offering during the third quarter of 2004 and a $51,000 impairment charge which was recorded to reduce the carrying value of the Company s investment in a Small Business Investment Company (SBIC) limited partnership.

Income Tax Provision. The Company s income tax provision increased $1.2 million to $1.7 million for 2005 compared to $519,000 in 2004 resulting from an increase in taxable income. The effective tax rate was 33.2% and 28.7% for 2005 and 2004, respectively. The lower 2004 effective tax rate reflects the Company s contribution of stock to SI Financial Group Foundation.

Comparison of Operating Results for the Years Ended December 31, 2004 and 2003

General. The Company recorded net income of $1.3 million, a decrease of $2.1 million, or 61.9%, for the year ended December 31, 2004 compared to $3.4 million for the year ended December 31, 2003. The decrease was primarily attributable to a $4.4 million increase in noninterest expense and a $537,000 decrease in noninterest income, offset by an increase of $619,000 in net interest income and decreases of $1.1 million for the provision for loan losses and $1.2 million for the provision for income taxes. An increase in net interest income in 2004 resulted from an increase in average assets and a decrease in the average cost of deposits and borrowings, offset by declining yields on interest-earning assets and an increase in average liabilities. For the year ended December 31, 2004, noninterest expenses included a $2.5 million contribution of common stock to SI Financial Group Foundation, resulting in a charge to earnings of $1.7 million after taxes. The Company established SI Financial Group Foundation, a charitable foundation, dedicated to community activities and the promotion of charitable causes in the areas in which the Bank operates. In connection with the offering, the Foundation was funded with 2%, or 251,275 shares, of the Company s common stock.

Interest and Dividend Income. Total interest and dividend income increased $672,000 (on a tax equivalent basis), or 2.4%, for 2004, despite a decrease in the average yield on interest-earning assets from 5.98% to 5.42%, as a result of an increase in the average balance of interest-earning assets from $467.2 million to $527.7 million. Interest on investment securities decreased in 2004 due to a 33 basis point decrease in the average yield to 3.94%, as a result of the unfavorable interest rate environment, offset by an increase in the average balance of investment securities. Although the average yield declined in 2004, interest on loans increased due to an increase in the average amount of loans outstanding.

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Interest Expense. Interest expense increased $54,000, or 0.6%, to $9.4 million for 2004 compared to $9.3 million in 2003 as a result of an increase in the average FHLB debt outstanding during the period, offset by a decrease in interest expense on interest-bearing deposit accounts. Although average interest-bearing liabilities increased $37.6 million, the cost of funds decreased as the average rate paid declined 16 basis points to 2.01% due to the prevailing lower interest rate environment.

Provision for Loan Losses. The Company s provision for loan losses decreased $1.1 million to $550,000 in 2004 from $1.6 million in 2003. Continued improvements in the real estate market has favorably impacted both our customers and the quality of our loan portfolio and improved asset quality. A lower interest rate market, resulting in lower payments on loans, has positively affected our variable rate borrowers. The decreased provision also reflected that the Company experienced lower charge-offs for the year ended December 31, 2004 and nonperforming loans were lower at December 31, 2004 as compared to December 31, 2003. In addition, the higher provision in 2003 was the result of a $1.6 million write-off of a large commercial real estate loan.

Noninterest Income. Total noninterest income decreased $537,000, or 11.4%, to $4.2 million in 2004. The following table shows the components of noninterest income and the dollar and percentage changes from 2003 to 2004.

	Years Ended December 31,		**Change**	
(Dollars in Thousands)	**2004**	**2003**	**Dollars**	**Percent**
Service fees	$ 2,941	$ 2,858	$ 83	2.9%
Wealth management fees	942	849	93	11.0
Increase in cash surrender value of BOLI	303	258	45	17.4
Net gain (loss) on sale of securities	(166)	121	(287)	(237.2)
Net gain on sale of loans	55	393	(338)	(86.0)
Other	110	243	(133)	(54.7)
TOTAL NONINTEREST INCOME	$ 4,185	$ 4,722	$ (537)	(11.4)%

Increases in electronic banking fees contributed to higher service fees in 2004 as more customers utilize the Bank s electronic banking products. Wealth management fees increased as a result of greater assets under management and more favorable portfolio performance than in 2003. The net decrease in gains on the sales of loans, which was impacted by lower loan sales in 2004 as compared to 2003, was the primary cause for the decrease in noninterest income. Noninterest income also decreased due to a loss on the sale of securities recorded in 2004 compared to a gain on the sale of securities in 2003.

Noninterest Expenses. Noninterest expenses increased by $4.4 million, or 26.6%, for 2004 as compared to 2003. The following table shows the components of noninterest expenses and the dollar and percentage changes from 2003 to 2004.

	Years Ended December 31,		**Change**	
(Dollars in Thousands)	**2004**	**2003**	**Dollar**	**Percent**
Salaries and employee benefits	$ 9,835	$ 9,090	$ 745	8.2%
Occupancy and equipment	3,465	2,973	492	16.5
Computer and electronic banking services	1,678	1,420	258	18.2
Outside professional services	815	500	315	63.0
Marketing and advertising	513	387	126	32.6
Supplies	293	266	27	10.2
Contribution to SI Financial Group Foundation	2,513		2,513	
Other	1,919	1,970	(51)	(2.6)
TOTAL NONINTEREST EXPENSES	$ 21,031	$ 16,606	$ 4,425	26.6%

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The primary reason for the increase in noninterest expenses resulted from the $2.5 million contribution of the Company s common stock to SI Financial Group Foundation in connection with the Company s initial public offering during the third quarter of 2004. Salaries and related benefits and taxes increased $745,000, or 8.2%, in 2004 over the prior year as the Company increased staffing levels in preparation for the public offering, expansion of branch facilities and the commercial lending division as well as normal wage increases. The expansion initiatives and technological improvements increased occupancy, furniture and equipment and computer services expenses in 2004. Of the $435,000 increase in occupancy expense for 2004 over 2003, $337,000 was related to an impairment charge to reduce the carrying value of a former branch facility to its estimated net market value. Outside professional services, which primarily includes legal and auditing services, reflects an increase of $315,000 in 2004 compared to 2003 attributable to the Bank s conversion from a state to federal charter and the additional costs associated with the increased reporting requirements and regulations of a publicly-held company. Electronic banking fees continue to rise as a result of greater electronic banking transactions.

Income Tax Provision. The Company s income tax expense decreased $1.2 million to $519,000 for 2004 compared to $1.7 million in 2003. The decrease in tax expense was due to a decrease in taxable income which was unfavorably impacted by the $2.5 million contribution of the Company s common shares to SI Financial Group Foundation. The effective tax rate was 28.7% and 33.6% for 2004 and 2003, respectively.

Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. The Company s primary sources of funds consist of deposit inflows, loan repayments and sales, maturities and sales of investment securities and borrowings from the FHLB. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

The Company regularly adjusts its investment in liquid assets based upon its assessment of (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities and (4) the objectives of the Company s asset/liability management, funds management and liquidity policies. The Company s policy is to maintain liquid assets less short-term liabilities within a range of 12.5% to 20.0% of total assets. Excess liquid assets are generally invested in interest-earning deposits and short- and intermediate-term government-sponsored enterprises and mortgage-backed securities.

The Company s most liquid assets are cash and cash equivalents. The levels of these assets depend on the Company s operating, financing, lending and investing activities during any given period. At December 31, 2005, cash and cash equivalents totaled $25.9 million, including interest-bearing deposits and federal funds sold of $9.6 million. Securities classified as available for sale, which provide additional sources of liquidity, totaled $120.0 million at December 31, 2005. In addition, at December 31, 2005, the Company had the ability to borrow a total of approximately $210.3 million from the FHLB, which includes overnight lines of credit of $6.2 million. On that date, the Company had FHLB advances outstanding of $87.9 million and no overnight advances outstanding.

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The Company believes that its most liquid assets combined with the available line from the FHLB provides adequate liquidity to meet its current financial obligations.

At December 31, 2005, the Bank had $91.1 million in loan commitments outstanding, which included $31.2 million in commitments to grant loans, $25.6 million in undisbursed construction loans, $21.5 million in unused home equity lines of credit, $10.8 million in commercial lines of credit, $1.3 million in overdraft protection lines and $812,000 in standby letters of credit. Certificates of deposit due within one year of December 31, 2005 totaled $129.9 million, or 25.4%, of total deposits (including mortgagors and investors escrow accounts). Management believes that the amount of deposits in shorter-term certificates of deposit reflects customers hesitancy to invest their funds in longer-term certificates of deposit in a rising interest rate environment. To compensate, the Bank has increased the duration of its borrowings with the FHLB. The Bank will be required to seek other sources of funds, including other certificates of deposit and lines of credit, if maturing certificates of deposit are not retained. Depending on market conditions, the Bank may be required to pay higher rates on such deposits or other borrowings than are currently paid on certificates of deposit. Additionally, a shorter duration in the securities portfolio may be necessary to provide liquidity to compensate for any deposit outflows. The Bank believes, however, based on past experience, a significant portion of its certificates of deposit will be retained. The Bank has the ability, if necessary, to adjust the interest rates offered to its customers in an effort to attract and retain deposits.

The Company s primary investing activities are the origination of loans and the purchase of securities. For the year ended December 31, 2005, the Bank originated $183.8 million of loans and purchased $27.0 million of securities. In fiscal 2004, the Bank originated $178.4 million of loans and purchased $90.7 million of securities.

Financing activities consist primarily of activity in deposit accounts and in FHLB advances. Asset growth has outpaced deposit growth during the last three years. The increased liquidity needed to fund asset growth has been provided through increased FHLB borrowings, raising capital through the issuance of trust preferred securities and proceeds from the initial public offering. The net increase in total deposits, including mortgagors and investors escrow accounts was $51.8 million, $43.2 million and $19.0 million for the years ended December 31, 2005, 2004 and 2003, respectively. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. The Bank generally manages the pricing of its deposits to be competitive and to increase core deposit and commercial banking relationships. Occasionally, the Bank offers promotional rates on certain deposit products to attract deposits. The Bank experienced increases in FHLB advances of $15.3 million, $15.5 million and $13.3 million for the years ended December 31, 2005, 2004 and 2003, respectively.

During 2005, the Company s shareholders approved an equity compensation plan (the Equity Plan). The Company utilized $2.9 million for the purchase of 246,249 common shares to fund all restricted stock award grants during the twelve months ended December 31, 2005. Additionally, the Company s Board of Directors approved a plan to repurchase approximately 628,000 shares of the Company s common stock. In 2005, the Company repurchased 12,564 shares, at a cost of $148,000, under this plan.

The Bank is subject to various regulatory capital requirements administered by the OTS, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At December 31, 2005, the Bank exceeded all of its regulatory capital requirements and is considered well capitalized under regulatory guidelines. As a savings and loan holding company regulated by the OTS, the Company is not subject to any separate regulatory capital

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requirements. *See Item 1. Business. Regulation and Supervision Regulation of Federal Savings Associations Capital Requirements and Note 14 in the Notes to the Consolidated Financial Statements for additional information relating to the Bank s regulatory capital requirements.*

Payments Due Under Contractual Obligations

The following table presents information relating to the Company s payments due under contractual obligations as of December 31, 2005.

	Payments Due by Period				
(Dollars in Thousands)	Less Than One Year	One to Three Years	Three to Five Years	More Than Five Years	Total
Long-term debt obligations	$ 13,161	$ 34,768	$ 23,000	$ 17,000	$ 87,929
Operating lease obligations	1,163	2,208	2,000	7,753	13,124
Other long-term liabilities reflected on the balance sheet				7,217	7,217
TOTAL CONTRACTUAL OBLIGATIONS	$ 14,324	$ 36,976	$ 25,000	$ 31,970	$ 108,270

Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with accounting principles generally accepted in the United States of America, are not recorded in its financial statements. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used primarily to manage customers requests for funding and take the form of loan commitments, lines of credit and letters of credit.

The contractual amounts of commitments to extend credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Financial instruments whose contract amounts represent credit risk at December 31, 2005 and 2004 are as follows:

	December 31,	
(Dollars in Thousands)	2005	2004
Commitments to extend credit: [(1)]		
Future loan commitments [(2)]	$ 31,192	$ 27,073
Undisbursed construction loans	25,572	27,527
Undisbursed home equity lines of credit	21,481	19,351
Undisbursed commercial lines of credit	10,796	8,433
Overdraft protection lines	1,277	1,060
Standby letters of credit [(3)]	812	997
TOTAL COMMITMENTS	$ 91,130	$ 84,441

(1) Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments may require payment of a fee and generally have fixed expiration dates or other termination clauses.

(2) Includes fixed rate loan commitments of $5.5 million at interest rates ranging from 4.875% to 8.000% and $10.2 million at interest rates ranging from 4.875% to 7.125% at December 31, 2005 and 2004, respectively.

(3) Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party.

In 1998, the Bank became a limited partner in a Small Business Investment Corporation (SBIC) and committed to a capital investment of $1.0 million in the limited partnership. At December 31, 2005 and 2004, the Bank s remaining off-balance sheet commitment for capital investment was approximately $194,000. *See Note 12 in the Notes to the Consolidated Financial Statements.*

In 2004, the Bank established an Employee Stock Ownership Plan for the benefit of its eligible employees. At December 31, 2005, the Bank had repaid principal payments on the loan to the ESOP of $286,000 and allocated 7,675 shares and committed to release 32,295 shares held in suspense for allocation to participants in 2006. As of December 31, 2005, the amount of unallocated common shares held in suspense totaled 452,135, with a fair value of $5.0 million, which represents a potential commitment of the Bank to the ESOP. *See Note 11 in the Notes to the Consolidated Financial Statements.*

Outstanding commitments for the construction of new branch facilities in the aggregate totaled approximately $870,000 at December 31, 2005. *See Note 6 in the Notes to the Consolidated Financial Statements.*

As of December 31, 2005, the Company did not engage in any off-balance sheet transactions reasonably likely to have a material effect on its financial condition, results of operations or cash flows. *See Note 12 in the Notes to the Consolidated Financial Statements.*

Impact of Inflation and Changes in Prices

The financial statements and financial data presented within this document have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation on our operations is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution s performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Impact of Recent Accounting Standards

Please refer to Note 1 - Nature of Business and Summary of Significant Accounting Policies Recent Accounting Pronouncements in the Notes to the Company s Consolidated Financial Statements for a detailed discussion of new accounting pronouncements and the impact on the Company s Consolidated Financial Statements.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Qualitative Aspects of Market Risk

The primary market risk factor affecting the financial condition and operating results of the Company is interest rate risk. Interest rate risk is the exposure of current and future earnings and capital arising from movements in interest rates. This risk is managed by periodic evaluation of the interest rate risk inherent in interest-earning assets and interest-bearing liabilities in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect earnings while decreases in interest rates may beneficially affect earnings. To reduce the potential volatility of earnings, the Company has sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Pursuant to this strategy, the Company originates adjustable-rate mortgage loans for retention in its loan portfolio. However, the ability to originate adjustable-rate loans depends, to a great extent, on market interest rates and borrowers preferences. As an alternative to adjustable-rate mortgage loans, the Company offers fixed-rate mortgage loans with maturities of fifteen years. This product enables the Company to compete in the fixed-rate mortgage market while maintaining a shorter maturity. Fixed-rate mortgage loans typically have an adverse effect on interest rate sensitivity compared to adjustable-rate loans. Accordingly, the Company has sold more long-term fixed-rate mortgage loans in the secondary market in recent periods to manage interest rate risk. In recent years, the Company also has used investment securities with terms of three years or less, longer-term borrowings from the FHLB and a four-year $5.0 million brokered deposit to help manage interest rate risk. The Company currently does not participate in hedging programs, interest rate swaps or other activities involving the use of derivative financial instruments.

The Company has an Asset/Liability Committee to communicate, coordinate and control all aspects involving asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

Quantitative Aspects of Market Risk

The Company analyzes its interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest rate sensitive. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The Company s goal is to manage asset and liability positions to moderate the effect of interest rate fluctuations on net interest and dividend income.

Income Simulation Analysis. Interest income simulations are completed quarterly and presented to the Company s Asset/Liability Committee. The simulations provide an estimate of the impact of changes in interest rates on net interest and dividend income under a range of assumptions. The numerous assumptions used in the simulation process are reviewed by the Asset/Liability Committee on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates. The simulation analysis incorporates management s current assessment of the risk that pricing margins will change adversely over time due to competition or other factors.

Simulation analysis is only an estimate of the Company s interest rate risk exposure at a particular point in time. The Company continually reviews the potential effect that changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

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The tables below set forth an approximation of the Company s exposure as a percentage of estimated net interest and dividend income for the next twelve and twenty-four-month periods using interest income simulation. The simulation uses projected repricing of assets and liabilities at December 31, 2005 and at December 31, 2004 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the Company s large percentage of loans and mortgage-backed securities, rising or falling interest rates have a significant impact on the prepayment speeds of its earning assets that in turn affect the rate sensitivity position. The prepayment rates on investment securities are assumed to fluctuate between 8% and 18% in a flat interest rate environment, between 6% and 12% in an increasing interest rate environment and between 18% and 60% in a decreasing interest rate environment, depending on the type of security. Loan prepayment rates are assumed to fluctuate between 6% and 24% in a flat interest rate environment, between 6% and 18% in a rising rate environment and between 6% and 65% in a falling rate environment, depending on the type of loan. As evidenced by these assumptions, when interest rates rise, prepayments tend to slow and when interest rates fall, prepayments tend to increase. The Company s asset sensitivity would be reduced if prepayments slow and vice versa. Because prospective effects of hypothetical interest rate changes are based on a number of assumptions, these computations should not be relied upon as indicative of actual results. While the Company believes such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed securities, collateralized mortgage obligations and loan repayment activity. Further, the computations do not reflect any actions that management may undertake in response to changes in interest rates. Management periodically reviews its rate assumptions based on existing and projected economic conditions.

The Company s management generally simulates changes to net interest and dividend income using three different interest rate scenarios. The first scenario anticipates the maximum foreseeable increase in rates over the next twelve months; management currently assumes this to be 300 basis points. The second scenario anticipates management s view of the most likely change in interest rates over the next twelve months; management s current assumption is a 100 basis point increase in rates. The third scenario anticipates the maximum foreseeable decrease in rates over the next twelve months; management s assumption was 200 basis points at December 31, 2005 and 100 basis points at December 31, 2004. The basis point change in each of the three scenarios is assumed to occur evenly over both the twelve and twenty-four months presented. As of December 31, 2005 and December 31, 2004, the Company s estimated exposure as a percentage of estimated net interest and dividend income for the twelve-month and twenty-four-month periods are as follows:

	Percent Change in Estimated Net Interest and Dividend Income Over	
As of December 31, 2005:	**12 Months**	**24 Months**
300 basis point increase in rates	(3.36)%	(5.56)%
100 basis point increase in rates	0.44	1.54
200 basis point decrease in rates	(4.28)	(7.55)

	Percent Change in Estimated Net Interest and Dividend Income Over	
As of December 31, 2004:	**12 Months**	**24 Months**
300 basis point increase in rates	(9.95)%	(12.57)%
100 basis point increase in rates	(3.20)%	(4.25)%
100 basis point decrease in rates	(3.70)%	(6.35)%

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As of December 31, 2005, based on the scenarios above, net interest and dividend income would be adversely affected in both the twelve and twenty-four-month periods if interest rates rose by 300 basis points or if interest rates decreased 200 basis points and favorably impacted by a 100 basis point increase in rates. Using net interest and dividend income for the quarter ended December 31, 2005, for each percentage point change in net interest and dividend income, the effect on the Company s annual net income would be $148,000, assuming a 34% income tax rate.

As of December 31, 2004, based on the scenarios above, net interest and dividend income would be adversely affected in both the twelve and twenty-four-month periods if interest rates rose by 100 or 300 basis points or if interest rates decreased 100 basis points. Using net interest and dividend income for the quarter ended December 31, 2004, for each percentage point change in net interest and dividend income, the effect on the Company s annual net income would be $140,000, assuming a 34% income tax rate.

For both the twelve and twenty-four-month periods, the effect on net interest and dividend income has improved, in the event of a sudden and sustained increase in prevailing market interest rates of 100 and 300 basis points at December 31, 2005 compared to December 31, 2004, as a result of the Company s strategy to better position the balance sheet for the continual rise in market interest rates primarily through the sale of fixed-rate residential mortgages.

Item 8. Financial Statements and Supplementary Data.

For the Company s Consolidated Financial Statements, see index on page 62.

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

None.

Item 9A. Controls and Procedures.

The Company s management, including the Company s principal executive officer and principal financial officer, have evaluated the effectiveness of the Company s disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (1) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (2) is accumulated and communicated to the Company s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Item 9B. Other Information.

None.

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PART III.

Item 10. Directors and Executive Officers of the Registrant.

The information concerning the directors and officers of the Company and information regarding compliance with Section 16(a) of the Exchange Act is incorporated herein by reference to the cover page of this Form 10-K, the Company s Proxy Statement for the 2006 Annual Meeting of Stockholders and to Part I, Item 1, Business - Executive Officers of the Registrant in this report.

Item 11. Executive Compensation.

The information regarding executive compensation is incorporated herein by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Stockholders.

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

The information relating to the security ownership of certain beneficial owners and management is incorporated herein by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Stockholders.

The following table sets forth information about the Company common stock that may be issued upon the exercise of stock options, warrants and rights under all of the Company s equity compensation plans as of December 31, 2005.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	463,500	$ 10.10	152,123
Equity compensation plans not approved by security holders			
Total	463,500	$ 10.10	152,123

Item 13. Certain Relationships and Related Transactions.

The information relating to certain relationships and related transactions is incorporated herein by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Stockholders.

Item 14. Principal Accountant Fees and Services.

The information relating to the principal accountant fees and expenses is incorporated herein by reference to the Company s Proxy Statement for the 2006 Annual Meeting of Stockholders.

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PART IV.

Item 15. Exhibits and Financial Statement Schedules.

(1) Financial Statements

The following consolidated financial statements of the Company and its subsidiaries are filed as part of this report:

Report of Independent Registered Public Accounting Firm (Wolf & Company, P.C.)

Report of Independent Registered Public Accounting Firm (McGladrey & Pullen, LLP)

Consolidated Statements of Financial Condition as of December 31, 2005 and 2004

Consolidated Statements of Income for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Changes in Stockholders Equity for the Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Cash Flows for the Years Ended December 31, 2005, 2004 and 2003

Notes to Consolidated Financial Statements

(2) Financial Statement Schedules

All financial statement schedules have been omitted because they are either not applicable or the required information is included in the Consolidated Financial Statements or Notes hereto.

(3) Exhibits

3.1	Charter of SI Financial Group, Inc. (1)
3.2	Bylaws of SI Financial Group, Inc. (1)
4.0	Specimen Stock Certificate of SI Financial Group, Inc. (1)
10.1	Employment Agreement by and among SI Financial Group, Inc. and Savings Institute Bank and Trust Company and Rheo A. Brouillard (2)
10.2	Employment Agreement by and among SI Financial Group, Inc. and Savings Institute Bank and Trust Company and Brian J. Hull (2)
10.3	Change in Control Agreement by and among SI Financial Group, Inc. and Savings Institute Bank and Trust Company and Michael J. Moran (2)
10.4	Form of Savings Institute Bank and Trust Company Employee Severance Compensation Plan (1)
10.5	Savings Institute Directors Retirement Plan (1)

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10.6	Form of Savings Institute Bank and Trust Company Supplemental Executive Retirement Plan [(1)]
10.7	Savings Institute Group Term Replacement Plan [(1)]
10.8	Form of Savings Institute Executive Supplemental Retirement Plan Defined Benefit[(1)]
10.9	Form of Savings Institute Director Deferred Fee Agreement [(1)]
10.10	Form of Savings Institute Director Consultation Plan [(1)]
10.11	Change in Control Agreement by and among SI Financial Group, Inc., Savings Institute Bank and Trust Company and Sonia M. Dudas [(2)]
10.12	SI Financial Group, Inc. 2005 Equity Incentive Plan [(3)]
10.13	Change in Control Agreement by and among SI Financial Group, Inc., Savings Institute Bank and Trust Company and Laurie L. Gervais
14.0	Code of Ethics and Business Conduct
21.0	List of Subsidiaries
23.0	Consent of McGladrey & Pullen, LLP
23.1	Consent of Wolf & Company, P.C.
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.0	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(1) Incorporated by reference into this document from the Exhibits filed with the Securities and Exchange Commission on the Registration Statement on Form S-1, and any amendments thereto, Registration No. 333-116381.

(2) Incorporated by reference into this document from the Exhibits filed with the Company s Form 10-Q for the quarter ended September 30, 2004, filed with the Securities and Exchange Commission on November 15, 2004.

(3) Incorporated by reference into this document from the Appendix to the Proxy Statement for the 2005 Annual Meeting of Stockholders filed with the Securities and Exchange Commission on April 6, 2005.

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SIGNATURES

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

SI Financial Group, Inc.

By: /s/ Rheo A. Brouillard
Rheo A. Brouillard
President and Chief Executive Officer
March 30, 2006

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

Name	Title	Date
/s/ Rheo A. Brouillard Rheo A. Brouillard	President and Chief Executive Officer (principal executive officer)	March 30, 2006
/s/ Brian J. Hull Brian J. Hull	Executive Vice President, Treasurer and Chief Financial Officer (principal accounting and financial officer)	March 30, 2006
/s/ Henry P. Hinckley Henry P. Hinckley	Chairman of the Board	March 30, 2006
/s/ Robert C. Cushman, Sr. Robert C. Cushman, Sr.	Director	March 30, 2006
/s/ Donna M. Evan Donna M. Evan	Director	March 30, 2006
/s/ Roger Engle Roger Engle	Director	March 30, 2006
/s/ Robert O. Gillard Robert O. Gillard	Director	March 30, 2006
/s/ Steven H. Townsend Steven H. Townsend	Director	March 30, 2006
/s/ Mark D. Alliod	Director	March 30, 2006

Mark D. Alliod

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SI FINANCIAL GROUP, INC.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of SI Financial Group, Inc.

We have audited the accompanying consolidated statement of financial condition of SI Financial Group, Inc. and subsidiaries as of December 31, 2005, and the related consolidated statements of income, changes in stockholders equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the 2005 consolidated financial statements referred to above present fairly, in all material respects, the financial position of SI Financial Group, Inc. and subsidiaries as of December 31, 2005, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Wolf & Company, P.C.

Boston, Massachusetts

February 23, 2006

99 High Street Boston, Massachusetts 02110-2320 Phone 617-439-9700 Fax 617-542-0400

1500 Main Street Suite 1500 Springfield, Massachusetts 01115 Phone 413-747-9042 Fax 413-739-5149

www.wolfandco.com

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REPORT OF INDEPENDENT REGISTERED

PUBLIC ACCOUNTING FIRM

To the Board of Directors

SI Financial Group, Inc. and Subsidiary

Willimantic, Connecticut

We have audited the accompanying consolidated statement of financial condition of SI Financial Group, Inc. and Subsidiary (the Company) as of December 31, 2004, and the related consolidated statements of income, changes in stockholders equity and cash flows for each of the two years in the period ended December 31, 2004. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SI Financial Group, Inc. and Subsidiary as of December 31, 2004, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

/s/ McGladrey & Pullen, LLP

New Haven, Connecticut

February 18, 2005

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SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars in Thousands, Except Share Amounts)

	December 31,	
	2005	**2004**
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$ 16,317	$ 21,647
Interest-bearing	6,829	8,728
Federal funds sold	2,800	400
Total cash and cash equivalents	25,946	30,775
Available for sale securities, at fair value	120,019	120,557
Loans held for sale	107	200
Loans receivable (net of allowance for loan losses of $3.7 million at December 31, 2005 and $3.2 million at December 31, 2004)	513,775	447,957
Accrued interest receivable	3,299	2,638
Federal Home Loan Bank Stock, at cost	5,638	4,313
Cash surrender value of bank-owned life insurance	7,837	7,561
Other real estate owned	325	
Premises and equipment, net	8,838	6,586
Goodwill and other intangibles	817	292
Deferred tax asset, net	2,804	2,044
Other assets	2,463	1,726
TOTAL ASSETS	$ 691,868	$ 624,649
LIABILITIES AND STOCKHOLDERS EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 51,996	$ 46,049
Interest-bearing	457,301	411,709
Total deposits	509,297	457,758
Mortgagors and investors escrow accounts	2,985	2,722
Federal Home Loan Bank advances	87,929	72,674
Junior subordinated debt owed to unconsolidated trust	7,217	7,217
Accrued expenses and other liabilities	4,397	3,469
TOTAL LIABILITIES	611,825	543,840
Commitments and contingencies (notes 6, 11 and 12)		
Stockholders Equity:		
Preferred stock ($.01 par value; 1,000,000 shares authorized; none issued or outstanding)		
Common stock ($.01 par value; 75,000,000 shares authorized; 12,563,750 shares issued and 12,551,186 shares outstanding at December 31, 2005; 12,563,750 shares issued and outstanding at December 31, 2004)	126	126
Additional paid-in capital	51,155	50,947
Unallocated common shares held by ESOP	(4,521)	(4,844)
Unearned restricted shares	(2,176)	

Retained earnings	37,216	34,870
Accumulated other comprehensive loss	(1,609)	(290)
Treasury stock, at cost (12,564 shares)	(148)	
TOTAL STOCKHOLDERS EQUITY	80,043	80,809
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 691,868	$ 624,649

See accompanying notes to consolidated financial statements.

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SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in Thousands, Except Share Amounts)

	Years Ended December 31,		
	2005	**2004**	**2003**
Interest and dividend income:			
Loans, including fees	$ 28,586	$ 24,545	$ 23,840
Investment securities:			
Taxable interest	4,744	3,658	3,787
Tax-exempt interest	21	24	27
Dividends	246	136	121
Other	308	240	155
TOTAL INTEREST AND DIVIDEND INCOME	33,905	28,603	27,930
Interest expense:			
Deposits	8,528	6,346	6,597
Federal Home Loan advances	3,108	2,683	2,315
Subordinated debt	495	371	360
Other borrowings			74
TOTAL INTEREST EXPENSE	12,131	9,400	9,346
NET INTEREST INCOME	21,774	19,203	18,584
Provision for loan losses	410	550	1,602
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	21,364	18,653	16,982
Noninterest income:			
Service fees	4,262	2,941	2,858
Wealth management fees	1,301	942	849
Increase in cash surrender value of BOLI	276	303	258
Net gain (loss) on sale of securities	59	(166)	121
Net gain on sale of loans	190	55	393
Other	222	110	243
TOTAL NONINTEREST INCOME	6,310	4,185	4,722
Noninterest expenses:			
Salaries and employee benefits	12,102	9,835	9,090
Occupancy and equipment	3,830	3,465	2,973
Computer and electronic banking services	1,823	1,678	1,420
Outside professional services	1,087	815	500
Marketing and advertising	794	513	387
Supplies	449	293	266
Contribution to SI Financial Group Foundation		2,513	
Other	2,503	1,919	1,970
TOTAL NONINTEREST EXPENSES	22,588	21,031	16,606

INCOME BEFORE INCOME TAXES	5,086	1,807	5,098
Income tax provision	1,689	519	1,713
NET INCOME	$ 3,397	$ 1,288	$ 3,385

See accompanying notes to consolidated financial statements.

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SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME - Concluded

(Dollars in Thousands, Except Share Amounts)

	Years Ended December 31,		
	2005	2004	2003
Net income per common share:			
Basic	$ 0.28	N/A	N/A
Diluted	$ 0.28	N/A	N/A
Weighted-average common shares outstanding:			
Basic	12,016,800	N/A	N/A
Diluted	12,041,316	N/A	N/A

See accompanying notes to consolidated financial statements.

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SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

(Dollars in Thousands, Except Share Amounts)

	Common Stock								
	Shares	Dollars	Additional Paid-in Capital	Unallocated Common Shares Held by ESOP	Unearned Restricted Shares	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
BALANCE AT DECEMBER 31, 2002		**$**	**$**	**$**	**$**	**$ 30,197**	**$ 1,211**	**$**	**$ 31,408**
Comprehensive income:									
Net income						3,385			3,385
Change in net unrealized loss on available for sale securities, net of reclassification adjustment and tax effects							(694)		(694)
Total comprehensive income									2,691
BALANCE AT DECEMBER 31, 2003						**33,582**	**517**		**34,099**
Issuance of common stock for initial public offering, net of expenses of $1.8 million	5,025,500	50	48,430						48,480
Issuance of common stock to SI Bancorp, MHC	7,286,975	73	(73)						
Issuance of common stock to SI Financial Group Foundation including additional tax benefit of $68 due to higher basis for tax purposes	251,275	3	2,578						2,581
Shares purchased for ESOP				(4,925)					(4,925)
Allocation of ESOP shares			12	81					93
Comprehensive income:									
Net income						1,288			1,288
Change in net unrealized loss on available for sale securities, net of reclassification adjustment and tax effects							(807)		(807)
Total comprehensive income									481

See accompanying notes to consolidated financial statements.

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SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY - Concluded

YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

(Dollars in Thousands, Except Share Amounts)

	Common Stock			Unallocated Common Shares Held by ESOP			Accumulated Other Comprehensive Income (Loss)		Total Stockholders Equity
	Shares	Dollars	Additional Paid-in Capital		Unearned Restricted Shares	Retained Earnings		Treasury Stock	
BALANCE AT DECEMBER 31, 2004	**12,563,750**	**126**	**50,947**	**(4,844)**		**34,870**	**(290)**		**80,809**
Cash dividends declared ($0.12 per share)						(590)			(590)
Restricted share grants and purchases					(2,487)	(461)			(2,948)
Equity incentive plan shares earned			165		311				476
Allocation of ESOP shares			43	323					366
Treasury stock purchased (12,564 shares)								(148)	(148)
Comprehensive income:									
Net income						3,397			3,397
Change in net unrealized loss on available for sale securities, net of reclassification adjustment and tax effects							(1,319)		(1,319)
Total comprehensive income									2,078
BALANCE AT DECEMBER 31, 2005	**12,563,750**	**$ 126**	**$ 51,155**	**$ (4,521)**	**$ (2,176)**	**$ 37,216**	**$ (1,609)**	**$ (148)**	**$ 80,043**

See accompanying notes to consolidated financial statements.

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SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	Years Ended December 31,		
	2005	**2004**	**2003**
Cash flows from operating activities:			
Net income	$ 3,397	$ 1,288	$ 3,385
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	410	550	1,602
Contribution of common stock to charitable foundation		2,513	
Employee stock ownership plan expense	366	93	
Equity incentive plan expense	476		
Amortization and accretion of investment premiums and discounts, net	53	111	466
Amortization and accretion of loan premiums and discounts, net	246	285	192
Depreciation and amortization of premises and equipment	1,359	1,074	1,039
Amortization of core deposit intangible	97	97	97
Amortization of deferred debt issuance costs	35	35	35
Amortization of mortgage servicing rights	64	24	
Deferred income tax provision (benefit)	(80)	(959)	166
Net loss (gain) on sales of securities	(59)	166	(121)
Loans originated for sale	(7,760)	(15,694)	(21,000)
Proceeds from sale of loans held for sale	7,874	15,549	22,996
Net decrease in loans held for sale			320
Net gain on sale of loans	(190)	(55)	(393)
Net gain on the sale of premises and equipment	(40)		
Net gain on sale of other real estate owned			(15)
Write-down of other real estate owned	25	60	
Increase in cash surrender value of bank-owned life insurance	(276)	(303)	(258)
Impairment charge long-lived assets		337	
Impairment charge other assets		51	36
Change in operating assets and liabilities:			
Accrued interest receivable	(661)	(400)	55
Other assets	(820)	36	(144)
Accrued expenses and other liabilities	723	1,123	212
NET CASH PROVIDED BY OPERATING ACTIVITIES	5,239	5,981	8,670
Cash flows from investing activities:			
Purchases of available for sale securities	(26,964)	(90,693)	(45,102)
Proceeds from sales of available for sale securities	159	22,845	11,650
Proceeds from maturities of and principal repayments on available for sale securities	25,350	23,836	42,323
Purchases of held to maturity securities			
Proceeds from sales of held to maturity securities		1,253	
Proceeds from maturities of and principal repayments on held to maturity securities		123	7,689
Net increase in loans	(94,315)	(61,868)	(55,907)
Purchases of Federal Home Loan Bank stock	(1,325)	(1,455)	(472)
Purchase of bank-owned life insurance policies			(7,000)
Purchase of trust subsidiary	(680)		
Proceeds from sale of portfolio loans	27,660		
Proceeds from sale of premises and equipment	571		
Proceeds from sales of other real estate owned		268	433
Purchases of bank premises and equipment	(4,053)	(1,322)	(1,619)

NET CASH USED IN INVESTING ACTIVITIES	(73,597)	(107,013)	(48,005)

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SI FINANCIAL GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - Concluded

(Dollars in Thousands)

	Years Ended December 31,		
	2005	2004	2003
Cash flows from financing activities:			
Net increase in deposits	51,539	42,668	18,740
Net increase in mortgagors and investors escrow accounts	263	501	256
Net decrease in collateralized borrowings			(851)
Proceeds from Federal Home Loan Bank advances	42,827	36,370	18,695
Repayments of Federal Home Loan Bank advances	(27,572)	(20,864)	(5,445)
Net proceeds from common stock offering		48,480	
Cash dividends paid on common stock	(432)		
Purchase of common stock for equity incentive plan	(2,948)		
Treasury stock purchased	(148)		
Acquisition of common stock by ESOP		(4,925)	
NET CASH PROVIDED BY FINANCING ACTIVITIES	63,529	102,230	31,395
NET CHANGE IN CASH AND CASH EQUIVALENTS	(4,829)	1,198	(7,940)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	30,775	29,577	37,517
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 25,946	$ 30,775	$ 29,577
SUPPLEMENTAL CASH FLOW INFORMATION:			
Interest and Income Taxes Paid:			
Interest paid on deposits and borrowed funds	$ 12,016	$ 9,367	$ 9,367
Income taxes paid	1,752	1,296	1,848
Noncash Activities:			
Unrealized losses on securities arising during the year	(1,999)	(1,224)	(1,050)
Transfer of loans to other real estate owned	350		703
Derecognition of loans and collateralized borrowings			1,100
Declared dividends	158		
Asset Purchase:			
In conjunction with the asset purchase of SI Trust Servicing, the following net assets were acquired for a purchase price of $680,000:			
Assets			
Fixed assets	$ 89	$	$
Goodwill	622		
Other assets	16		
Total assets acquired	727		
Liabilities			
Accrued expenses	2		
Transaction costs	45		
Total liabilities assumed	47		
Net assets acquired	$ 680	$	$

See accompanying notes to consolidated financial statements.

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