

MSB FINANCIAL CORP.
Form 10-K
September 28, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

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

(Mark One)

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

For the fiscal year ended: June 30, 2011 or

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

For the transition period from _____ to _____

Commission File No. 001-33246

MSB FINANCIAL CORP.

(Exact name of Registrant as specified in its Charter)

United States
(State or other Jurisdiction of
Incorporation or Organization)

34-1981437
(I.R.S. Employer Identification
No.)

1902 Long Hill Road, Millington, New Jersey
(Address of Principal Executive Offices)

07946-0417
(Zip Code)

Registrant's telephone number, including area code: 908-647-4000

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.10 par value	The Nasdaq Stock Market LLC

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
[] YES [] NO

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price of the Registrant's common stock as quoted on the Nasdaq Stock Market LLC on December 31, 2010, was approximately \$12.3 million.

As of September 26, 2011 there were 5,164,804 shares outstanding of the Registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2011 Annual Meeting of Shareholders. (Parts II and III)

MSB FINANCIAL CORP.

FORM 10-K

FOR THE FISCAL YEAR ENDED JUNE 30, 2011

INDEX

	Page
PART I	
Item 1. Business	1
Item 1A. Risk Factors	31
Item 1B. Unresolved Staff Comments	31
Item 2. Properties	32
Item 3. Legal Proceedings	32
Item 4. [Removed and Reserved]	32
PART II	
Item 5. Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	33
Item 6. Selected Financial Data	34
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	34
Item 7A. Quantitative and Qualitative Disclosures about Market Risk	45
Item 8. Financial Statements and Supplementary Data	46
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	46
Item 9A. Controls and Procedures	47
Item 9B. Other Information	48
PART III	
Item 10. Directors, Executive Officers and Corporate Governance	48
Item 11. Executive Compensation	48
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	48
Item 13. Certain Relationships and Related Transactions, and Director Independence	49
Item 14. Principal Accountant Fees and Services	49
PART IV	
Item 15. Exhibits and Financial Statement Schedules	49

PART I

Forward-Looking Statements

MSB Financial Corp. (the “Company”) may from time to time make written or oral “forward-looking statements,” including statements contained in the Company’s filings with the Securities and Exchange Commission (including this Annual Report on Form 10-K and the exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the “safe harbor” provisions of the private securities litigation reform act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company’s plans, objectives, expectations, estimates and intentions, that are subject to change based on various important factors (some of which are beyond the Company’s control). The following factors, among others, could cause the Company’s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: The strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the board of governors of the federal reserve system, inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors’ products and services; the willingness of users to substitute competitors’ products and services for the Company’s products and services; the success of the Company in gaining regulatory approval of its products and services, when required; the impact of changes in financial services’ laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes, acquisitions; market volatility; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

Item 1. Business

General

The Company is a federally chartered corporation organized in 2004 for the purpose of acquiring all of the capital stock that Millington Savings Bank (the “Bank”) issued in its mutual holding company reorganization. During the fiscal year ended June 30, 2007, the Company conducted its initial public offering and sold 2,529,281 shares for net proceeds of approximately \$24.5 million. The Company’s principal executive offices are located at 1902 Long Hill Road, Millington, New Jersey 07946-0417 and its telephone number at that address is (908) 647-4000.

MSB Financial, MHC (the “MHC”) is a federally chartered mutual holding company that was formed in 2004 in connection with the mutual holding company reorganization. The MHC has not engaged in any significant business since its formation. So long as the MHC is in existence, it will at all times own a majority of the outstanding stock of the Company.

The Bank is a New Jersey-chartered stock savings bank and its deposits are insured by the Federal Deposit Insurance Corporation. As of June 30, 2011, the Bank had 52 full time equivalent employees.

The Bank is regulated by the New Jersey Department of Banking and Insurance and the Federal Deposit Insurance Corporation. The MHC and the Company are now regulated as savings and loan holding companies by the Board of Governors of the Federal Reserve System (“FRB”), as successor to the Office of Thrift Supervision (“OTS”) under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Throughout this document, references to “we,” “us,” or “our” refer to the Bank or Company, or both, as the context indicates.

Competition

We operate in a market area with a high concentration of banking and other financial institutions, and we face substantial competition in attracting deposits and in originating loans. A number of our competitors are significantly larger institutions with greater financial and managerial resources and lending limits. Our ability to compete successfully is a significant factor affecting our growth potential and profitability.

Our competition for deposits and loans historically has come from other insured financial institutions such as local and regional commercial banks, savings institutions, and credit unions located in our primary market area. We also compete with mortgage banking and finance companies for real estate loans and with commercial banks and savings institutions for consumer loans, and we face competition for funds from investment products such as mutual funds, short-term money funds and corporate and government securities. There are large competitors operating throughout our total market area, and we also face strong competition from other community-based financial institutions.

Lending Activities

We have traditionally focused on the origination of one-to-four family loans and home equity loans and lines of credit, which together comprise a substantial portion of the total loan portfolio. We also provide financing for commercial real estate, including multi-family dwellings/apartment buildings, service/retail and mixed-use properties, churches and non-profit properties, medical and dental facilities and other commercial real estate. In recent years, construction loans have decreased as a component of our portfolio. We also originate commercial and industrial loans. Our consumer loans are comprised of auto loans, personal loans and account loans.

Edgar Filing: MSB FINANCIAL CORP. - Form 10-K

Loan Portfolio Composition. The following tables analyze the composition of the Bank's portfolio by loan category at the dates indicated. Except as set forth below, there were no concentrations of loans exceeding 10% of total loans.

	2011		2010		At June 30, 2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Type of Loans:										
One-to-four family real estate	\$ 149,399	57.66%	\$ 155,241	56.94%	\$ 155,143	54.68%	\$ 145,868	56.31%	\$ 123,601	50.94%
Commercial real estate	32,559	12.57	33,776	12.39	34,115	12.03	30,068	11.61	28,989	11.95
Construction	16,633	6.42	16,639	6.10	20,978	7.39	17,771	6.86	23,822	9.82
Consumer	941	0.36	918	0.34	1,106	0.39	1,259	0.49	1,995	0.82
Home equity	50,240	19.39	56,862	20.86	62,179	21.92	54,778	21.15	55,896	23.04
Commercial and industrial	9,325	3.60	9,190	3.37	10,176	3.59	9,285	3.58	8,338	3.43
Total loans receivable	259,097	100.00%	272,626	100.00%	283,697	100.00%	259,029	100.00%	242,641	100.00%
Less:										
Construction loans in process	(3,452)		(4,027)		(5,609)		(3,568)		(7,999)	
Allowance for loan losses	(2,170)		(2,588)		(1,808)		(1,025)		(926)	
Deferred loan fees	(224)		(197)		(222)		(146)		(218)	
Total loans receivable, net	\$253,251		\$265,814		\$276,058		\$254,290		\$233,498	

Loan Maturity Schedule. The following table sets forth the maturity of the Bank's loan portfolio at June 30, 2011. Demand loans, loans having no stated maturity, and overdrafts are shown as due in one year or less. Undisbursed amounts on construction loans totaling \$3.5 million at June 30, 2011 are not shown in the table. The table shows contractual maturities and does not reflect repricing or the effect of prepayments. Actual maturities may differ.

At June 30, 2011

	One-to-Four Family Real Estate	Commercial Real Estate	Construction	Consumer (In thousands)	Home Equity	Commercial and Industrial	Total
Amounts Due: Within 1 Year	\$11,840	\$ 3,789	\$ 12,693	\$701	\$360	\$2,931	\$32,314
After 1 year:							
1 to 5 years	23,305	8,324	488	157	6,814	5,029	44,117
5 to 10 years	12,891	8,025	—	83	20,341	123	41,463
After 10 years	101,363	12,421	—	—	22,725	1,242	137,751
Total due after one year	137,559	28,770	488	240	49,880	6,394	223,331
	\$149,399	\$ 32,559	\$ 13,181	\$941	\$50,240	\$9,325	\$255,645

The following table sets forth the dollar amount of all loans at June 30, 2011 due after June 30, 2012, which have fixed interest rates and which have floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates (In thousands)	Total
One-to-four family real estate	\$ 134,363	\$ 3,196	\$ 137,559
Commercial real estate	28,770	—	28,770
Construction	488	—	488
Consumer	46	194	240
Home equity	25,613	24,267	49,880
Commercial and industrial	2,024	4,370	6,394
Total	\$ 191,304	\$ 32,027	\$ 223,331

One-to-Four Family Real Estate Mortgages. Our primary lending activity consists of the origination of one-to-four family first mortgage loans. Fixed rate, conventional mortgage loans are offered by the Bank with terms from 5 to 30 years. A bi-weekly payment option is available wherein a payment is made every fourteen days via automatic deduction from the borrower's Millington Savings Bank account.

We also originate fixed rate balloon mortgages with terms of 3 to 10 years and flexible amortizations. At the end of each term the mortgage may be paid off in full with no penalty or, provided that the loan is in good standing and there has been no negative change in value of the collateral, we may extend the existing mortgage on new terms, at a new interest rate. If the mortgage is extended, there may be additional charges at the time of each extension.

We originate adjustable rate mortgages, or ARMs, with up to 30 year terms at rates based upon the U.S. Treasury One Year Constant Maturity as an index. Our ARMs currently reset on an annual basis, beginning with the first year, and have a 200 basis point annual increase cap and a 600 basis point lifetime adjustment cap. We do not originate "teaser" rate or negative amortization loans.

Substantially all residential mortgages include "due on sale" clauses, which are provisions giving the lender the right to declare a loan immediately payable if the borrower sells or otherwise transfers an interest in the property to a third party. Property appraisals on real estate securing one-to-four family residential loans are made by state certified or licensed independent appraisers and are performed in accordance with applicable regulations and policies. We require title insurance policies on all first lien one-to-four family residential loans. Homeowners, liability, fire and, if applicable, flood insurance policies are also required.

We provide financing on residential investment properties with either 3 to 10 year balloon mortgages, 3, 5, 7 or 10 year adjustable rate mortgages or 5 to 30 year fixed duration mortgages. At the end of each term a balloon mortgage on an investment property may be paid off in full with no penalty or, provided that the loan is in good standing and there has been no negative change in the value of the collateral, we may extend the existing mortgage on new terms, at a new interest rate. If the mortgage is extended, there may be additional charges at the time of each extension. Our investment property lending product is available to individuals or proprietorships, partnerships, limited liability corporations, and corporations with personal guarantees. All investment property is underwritten on its ability substantially to carry itself, unless the property is a two-family residence with the mortgagor living in one of the units.

Preference is given to those loans where rental income covers all operating expenses, including but not limited to principal and interest, real estate taxes, hazard insurance, utilities, maintenance, and reserve. The cash coverage ratio to cover operating expenses must be at least 1.50 times. Any negative cash flow will be included in the limit on the borrower's total debt ratio.

We generally originate one-to-four family first mortgage loans, for primary residence or investment, for up to 80% loan-to-value.

Commercial Real Estate Mortgages. Our commercial real estate lending includes multi-family dwellings/apartment buildings, service/retail and mixed-use properties, churches and non-profit properties, medical and dental facilities and other commercial real estate. Our commercial real estate mortgage loans are either 3 to 10 year balloon mortgages (with a maximum amortization period of 25 years) or 15 year fixed duration mortgages. This type of lending is made available to proprietorships, partnerships, and corporations with personal guarantees. All commercial property is underwritten on its ability substantially to provide satisfactory cash flows. A cash flow and lease analysis is performed for each property. Preference is given to those loans where rental income covers all operating expenses, including but not limited to principal and interest, real estate tax, hazard insurance, utilities, maintenance, and reserve. The cash coverage ratio to cover operating expenses must be at least 1.25%. Any negative cash flow will be included in the limit on the borrower's total debt ratio. Cash from other assets of the borrower, who may own multiple properties and generate a surplus, can be made available to cover debt-service shortages of the financed property. The maximum loan-to-value ratio on most commercial real estate loans we originate is 80%.

The management skills of the borrower are judged on the basis of his/her professional experience and must be documented to meet the Bank's satisfaction in relation to the desired project. The assets of the borrower must indicate his/her ability to support the proposed investment, both in terms of liquidity and net worth, and tangible history of the borrower's capability and experience must be evident.

Unlike single-family residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income, and which are secured by real property the value of which tends to be more easily ascertainable, multi-family and commercial real estate loans typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business or rental income. As a result, the availability of funds for the repayment of commercial real estate and multi-family loans may be substantially dependent on the success of the business itself and the general economic environment. Commercial real estate and multi-family loans, therefore, have greater credit risk than one-to-four family residential mortgages or consumer loans. In addition, commercial real estate and multi-family loans generally result in larger balances to single borrowers, or related groups of borrowers and also generally require substantially greater evaluation and oversight efforts.

Construction Loans. We originate construction and land acquisition loans for an owner-occupied residence or to a builder with a valid contract of sale. With prior Board of Director approval, we also provide financing for speculative residential or commercial construction and development. Individual consideration is given to builders based on their past performance, workmanship, and financial worth. Our construction lending includes loans for construction or major renovations or improvements of owner-occupied residences; however, the majority of this portfolio consists of real estate developers.

Construction loans are mortgages with up to an 18 month duration. Funds are disbursed periodically upon inspections made by our inspectors on the percentage of work completed, as per the approved budget. Funds disbursed may not exceed 50% of loan-to-value of land and 75% loan-to-value of improvements any time during construction. Interest rates on disbursed funds are based on the rates and

terms set at the time of closing. The majority of our construction lending is variable rate loans with rates tied to the prime rate published in The Wall Street Journal, plus a premium. Payments on disbursed funds must be made on a monthly basis. The loan-to-value limitation on land acquisition loans is 50%.

Construction lending is generally considered to involve a higher degree of credit risk than residential mortgage lending. If the estimate of construction cost proves to be inaccurate, we may be compelled to advance additional funds to complete the construction with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If we are forced to foreclose on a project prior to completion, there is no assurance that we will be able to recover the entire unpaid portion of the loan. In addition, we may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time.

Consumer Loans. Our consumer lending products consist of new and used auto loans, secured and unsecured personal loans, account loans and overdraft lines of credit. The maximum term for a loan on a new or used automobile is six years and four years, respectively. We will lend up to 80% of retail value or dealer invoice on a car loan. We offer a reduction on the interest rate for car loans with payments automatically deducted from the borrower's checking or statement savings account with us.

Our personal loans have terms of up to four years with a minimum and maximum balance of \$1,000 and \$5,000, respectively. A reduction to the interest rate is offered for loans with automatic debit repayment from a checking or statement savings account with us. Our account loans permit a depositor to borrow up to 90% of his or her funds on deposit with us in certificate of deposit accounts. The interest rate is the current rate paid to the depositor, plus a premium. A minimum payment of interest only is required. We offer an overdraft line of credit with a minimum of \$500 and up to a maximum of \$5,000 and an interest rate tied to the prime rate published in The Wall Street Journal, plus a premium.

Consumer lending is generally considered to involve a higher degree of credit risk than residential mortgage lending. Consumer loan repayment is dependent on the borrower's continuing financial stability and can be adversely affected by job loss, divorce, illness, personal bankruptcy and other factors. 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 consumer loans in the event of a default. Account loans are fully secured.

Home Equity Loans and Lines of Credit. We offer fixed rate home equity loans and variable rate home equity lines of credit with a minimum credit limit of \$5,000. Collateral valuation is established through a variety of methods, including an on-line appraisal valuation estimator, drive by appraisals, recent assessed tax value, purchase price or consideration value as evidenced by a deed or property search report or a report of real estate comparables from a licensed realtor. Loan requests over \$100,000, however, require full appraisals, and requests over \$500,000 require Loan Committee approval. Loan requests over \$1.0 million require Board approval. The loan-to-value limit on home equity lending is 80% on owner occupied property and 70% on investment property. The variable rate on home equity lines of credit is adjusted monthly and is currently set at prime for owner occupied properties and prime plus a premium for investment properties. The fixed rate loans on investment property are also higher than fixed rate owner occupied home equity loans. We generally provide home equity financing only for a first or second lien position.

Our fixed rate home equity loans have terms of 5 to 30 years. Our variable rate home equity lines of credit have terms of 15 years, and we also offer an interest only home equity line of credit based on a 10 year term. The loan-to-value limit on interest only home equity financing is 70% on owner occupied property and 60% on investment property. We also offer bridge loans with a variable rate and a 70% loan-to-value limit on owner occupied property and 60% on investment property.

Commercial and Industrial Loans. We offer revolving lines of credit to businesses to finance short-term working capital needs like accounts receivable and inventory. These lines of credit may be unsecured or secured by accounts receivable and inventory or real estate. We generally provide such financing for no more than a 3 year term and with a variable rate.

We also originate commercial term loans to fund longer-term borrowing needs such as purchasing equipment, property improvements or other fixed asset needs. These loans are secured by new and used machinery, equipment, fixtures, furniture or other long-term fixed assets and have terms of 1 to 15 years. We originate commercial term loans for other general long-term business purposes, and these loans are secured by real estate. Interest on commercial term loans is payable monthly and principal may be payable monthly or quarterly.

The normal minimum amount for our commercial term loans and lines of credit is \$5,000. We generally will not lend more than \$100,000 on a commercial line of credit or \$500,000 on a commercial term loan. We typically do not provide working capital loans to businesses outside our normal market area or to new businesses where repayment is dependent solely on future profitable operation of the business. We avoid originating loans for which the primary source of repayment could be liquidation of the collateral securing the loan in light of poor repayment prospects. We typically require personal guarantees on all commercial loans, regardless of other collateral securing the loan.

The loan-to-value limits related to commercial lending vary according to the collateral. Loans secured by real estate may be originated for up to 80% loan-to-value. Other limits are as follows: Savings accounts-90% of the deposit amount; new equipment-75% of purchase price; and used equipment-lesser of 75% of purchase price or 75% of current market value.

Loans to One Borrower. The Bank's regulatory limit on total loans to any borrower or attributed to any one borrower is 15% of unimpaired capital and surplus. Accordingly, as of June 30, 2011, our loans to one borrower legal limit was approximately \$5.3 million.

The Bank's lending policies require Board approval before any borrower's existing and/or committed borrowings from the Bank may exceed \$1.0 million in aggregate. Any single loan in excess of \$1.0 million also requires prior Board approval.

Loan Originations, Purchases, Sales, Solicitation and Processing. Our customary sources of loan applications include repeat customers, referrals from realtors and other professionals and "walk-in" customers. Our residential loan originations are driven by the Bank's reputation, as opposed to being advertising driven.

We normally do not sell loans into the secondary mortgage market and did not sell any loans in the five year period ended June 30, 2011. Because it has been our policy to retain the loans we originate in our portfolio, we have not uniformly originated our real estate mortgage loans to meet the documentation standards to sell loans in the secondary mortgage market. We may do so, however, in the future if we find it desirable in connection with interest rate risk management to sell longer term fixed rate mortgages into the secondary mortgage market.

We did not purchase any whole loans in the five-year period ended June 30, 2011. We did, however, purchase insignificant participation interests in loans originated by other banks during this period.

Loan Approval Procedures and Authority. Lending policies and loan approval limits are approved and adopted by the Board of Directors. Lending authority is vested primarily in President and Chief Executive Officer Gary Jolliffe, Executive Vice President and Chief Operating Officer Michael Shriner and Vice President and Chief Lending Officer Nancy Schmitz. Each of these officers may approve loans within the following limits: first mortgage real estate and construction loans up to \$500,000; home equity loans up to \$500,000; consumer loans up to \$500,000; and commercial loans up to \$500,000. Loans in excess of \$500,000 but under \$1.0 million require the approval of the Loan Committee. Prior Board approval is required for all loan products in excess of \$1.0 million. The Board also must give prior approval for any aggregation of existing and/or committed loans to one borrower that exceed \$1.0 million. Certain other Bank employees also have limited lending authority.

Asset Quality

Loan Delinquencies and Collection Procedures. The Bank's procedures for delinquent loans are as follows:

- 1 5 d a y slate charge added, first delinquent notice mailed
delinquent:
- 3 0 d a y ssecond delinquent notice mailed
delinquent:
- 4 5 d a y sadditional late charge, third delinquent notice mailed,
delinquent: telephone contact made
- 6 0 d a y stelephone contact made, separate letter mailed
delinquent:
- 9 0 d a y sdecision made to foreclose or workout
delinquent:

When a loan is 90 days delinquent, the Vice President - Lending may determine to refer it to an attorney for repossession or foreclosure. All reasonable attempts are made to collect from borrowers prior to referral to an attorney for collection. In certain instances, we may modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize his or her financial affairs, and we attempt to work with the borrower to establish a repayment schedule to cure the delinquency.

As to mortgage loans, if a foreclosure action is taken and the loan is not reinstated, paid in full or refinanced, the property is sold at judicial sale at which we may be the buyer if there are no adequate offers to satisfy the debt. Any property acquired as the result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold or otherwise disposed of. When real estate owned is acquired, it is recorded at the lower of cost or its fair market value less estimated selling costs. The initial writedown of the property is charged to the allowance for loan losses. Adjustments to the carrying value of the property that result from subsequent declines in value are charged to operations in the period in which the declines occur. At June 30, 2011, we held \$861,000 in real estate owned.

As to commercial loans, the Bank requests updated financial statements when the loan becomes 90 days delinquent. As to account loans, the outstanding balance is collected from the related account along with accrued interest when the loan is 180 days delinquent.

Loans are reviewed on a regular basis, and all delinquencies of 60 days or more are reported to the Board of Directors. Loans are placed on non-accrual status when they are more than 90 days delinquent, except for such loans which are "well secured" and "in the process of collection." In addition a loan may be placed on non-accrual status at any time if, in the opinion of management, the collection of the loan in full is doubtful. An asset is "well secured" if it is secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party. An asset is "in process of collection" if collection of the asset is proceeding in due course either (1)

through legal action, including judgment enforcement procedures, or (2) in appropriate circumstances,

through collection efforts not involving legal action which are reasonably expected to result in repayment of the debt or its restoration to a current status in the near future.

Interest accrued and unpaid during the year the loan is placed on non-accrual status is charged against interest income. Interest accrued and unpaid in prior years is charged against the allowance for loan losses. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectability of the loan. At June 30, 2011, we had approximately \$14.1 million of loans that were held on a non-accrual basis, all of which were classified as impaired with \$3.6 million subject to specific loss allowances totaling \$685,000.

Non-Performing Assets. The following table provides information regarding our non-performing loans and other non-performing assets as of the dates indicated.

	2011	2010	At June 30, 2009	2008	2007
	(Dollars in thousands)				
Loans accounted for on a non-accrual basis:					
One-to-four family real estate	\$ 8,317	\$ 6,764	\$ 3,714	\$ 1,234	\$ 116
Commercial real estate	3,132	3,465	926	410	-
Construction	1,027	864	-	-	666
Consumer	2	9	-	-	-
Home equity	950	2,281	1,356	634	634
Commercial and industrial	642	514	550	658	166
Total	14,070	13,897	6,546	2,936	1,582
Accruing loans contractually past due 90 days or more:					
One-to-four family real estate	1,369	1,439	2,394	1,615	740
Commercial real estate	-	-	-	378	-
Construction	-	-	250	-	-
Consumer	-	2	10	16	-
Home equity	934	321	78	234	27
Commercial and industrial	-	-	377	-	-
Total	2,303	1,762	3,109	2,243	767
Total non-performing loans	\$ 16,373	\$ 15,659	\$ 9,655	\$ 5,179	\$ 2,349
Total non-performing assets (1)	\$ 17,234	\$ 16,726	\$ 9,655	\$ 5,179	\$ 2,349
Troubled Debt Restructurings	\$ -	\$ 896	\$ -	\$ -	\$ -
Total non-performing loans to total loans	6.32%	5.74%	3.40%	2.00%	0.97%
Total non-performing loans to total assets	4.69%	4.36%	2.74%	1.68%	0.83%
Total non-performing assets to total assets	4.93%	4.66%	2.74%	1.68%	0.83%

(1) Total non-performing assets consist of total non-performing loans and other real estate owned of \$861, \$1,067, \$ -, \$ -, and \$ - at June 30, 2011, 2010, 2009, 2008 and 2007.

During the year ended June 30, 2011, gross interest income of \$843,000 would have been recorded on loans accounted for on a non-accrual basis if those loans had been current, and \$308,000 of interest collected on a cash basis was included in income.

Classified Assets. Management, in compliance with the Uniform Credit Classification and Account Management Policy adopted by the Federal Deposit Insurance Corporation, has instituted an internal loan review program, whereby non-performing loans are classified as special mention, substandard, doubtful or loss. It is our policy to review the loan portfolio, in accordance with regulatory classification procedures, on at least a quarterly basis. When a loan is classified as substandard or doubtful, management is required to evaluate the loan for impairment. When management classifies a portion of a loan as loss, a reserve equal to 100% of the loss amount is required to be established or the loan is to be charged-off, if a conforming loss event has occurred.

An asset that does not currently expose the Bank to a sufficient degree of risk to warrant an adverse classification, but which possesses credit deficiencies or potential weaknesses that deserve management’s close attention is classified as “special mention.”

An asset classified as “substandard” is inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged, if any. Assets so classified have well-defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

An asset classified as “doubtful” has all the weaknesses inherent in a “substandard” asset with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of a loss on a doubtful asset is high.

That portion of an asset classified as “loss” is considered uncollectible and of such little value that its continuance as an asset, without establishment of a specific valuation or charge-off, is not warranted. This classification does not necessarily mean that an asset has absolutely no recovery or salvage value; but rather, it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be effected in the future.

Management’s classification of assets is reviewed by the Board on a regular basis and by the regulatory agencies as part of their examination process. An independent loan review firm performs periodic reviews of our loan portfolio.

The following table discloses the Bank’s classification of assets as of June 30, 2011.

	At June 30, 2011 (In thousands)
Special Mention	\$ 1,227
Substandard	8,134
Doubtful	