Ottawa Savings Bancorp, Inc.
Form 10-K
March 28, 2012
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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, 2011

or

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

For transition period from to

Commission File Number 0-51367

OTTAWA SAVINGS BANCORP, INC.

(Exact Name of Registrant as Specified in Charter)

United States **(State or other Jurisdiction** **of Incorporation)**	**20-3074627** **(I.R.S. Employer** **Identification No.)**
925 LaSalle Street, Ottawa, Illinois **(Address of Principal Executive Offices)**	**61350** **(Zip Code)**

Registrant s telephone number, including area code: (815) 433-2525

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

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ 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 issuer (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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 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 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. 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 ¨	Accelerated Filer ¨

Non-Accelerated filer ¨ (do not check if a smaller reporting company) Smaller Reporting Company 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.

As of June 30, 2011, the aggregate market value of the voting common equity held by non-affiliates of the registrant was approximately $6,040,751 (based on the last sale price of the common stock on the OTC Bulletin Board of $7.84 per share).

The number of shares of Common Stock of the registrant issued and outstanding as of March 28, 2012 was 2,117,979.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its 2012 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to SEC Regulation 14A are incorporated by reference into Part III.

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OTTAWA SAVINGS BANCORP, INC.

Form 10-K for Fiscal Year Ended

December 31, 2011

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PART I

Forward-Looking Statements

This report includes forward-looking statements, including statements regarding our strategy, effectiveness of investment programs, evaluations of future interest rate trends and liquidity, expectations as to growth in assets, deposits and results of operations, future operations, market position, financial position, and prospects, plans and objectives of management. These forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, can generally be identified by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain and actual results may differ materially from those predicted in such forward-looking statements. A number of factors, some of which are beyond our ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to: recent and future bail out actions by the government; a further slowdown in the national and Illinois economies; a further deterioration in asset values locally and nationwide; volatility of rate sensitive deposits; changes in the regulatory environment; increasing competitive pressure in the banking industry; operational risks; asset/liability matching risks and liquidity risks; continued access to liquidity sources; changes in the securities markets; changes in our borrowers performance on loans; changes in critical accounting policies and judgments; changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies; changes in the equity and debt securities markets; effect of additional provision for loan losses; fluctuations of our stock price; success and timing of our business strategies; impact of reputation risk created by these developments on such matters as business generation and retention, funding and liquidity; and political developments, wars or other hostilities that may disrupt or increase volatility in securities or otherwise affect economic conditions. The consequences of these factors, any of which could hurt our business, could include, among others: increased loan delinquencies; an escalation in problem assets and foreclosures; a decline in demand for our products and services; a reduction in the value of the collateral for loans made by us, especially real estate, which, in turn would likely reduce our customers borrowing power and the value of assets and collateral associated with our existing loans; a reduction in the value of certain assets held by our company; an inability to meet our liquidity needs and an inability to engage in certain lines of business. These risks and uncertainties should be considered in evaluating forward-looking statements, and undue reliance should not be placed on such statements. Except to the extent required by applicable law or regulation the Company does not undertake any obligation to update any forward-looking statement to reflect circumstances or events that occur after the date the forward-looking statements are made. See also Item 1A. Risk Factors and other risk factors discussed elsewhere in this Annual Report.

ITEM 1. BUSINESS

General

Ottawa Savings Bancorp, Inc. (the Company) was incorporated under the laws of the United States on July 11, 2005, for the purpose of serving as the holding company of Ottawa Savings Bank (the Bank), as part of the Bank s conversion from a mutual to a stock form of organization. The Company is a publicly traded banking company with assets of $182.9 million at year-end 2011 and is headquartered in Ottawa, Illinois.

In 2005, the Board of Directors of the Bank unanimously adopted a plan of conversion providing for the conversion of the Bank from an Illinois chartered mutual savings bank to a federally chartered stock savings bank and the purchase of all of the common stock of the Bank by the Company. The depositors of the Bank approved the plan at a meeting held in 2005.

In adopting the plan, the Board of Directors of the Bank determined that the conversion was advisable and in the best interests of its depositors and the Bank. The conversion was completed in 2005 when the Company issued 1,223,701 shares of common stock to Ottawa Savings Bancorp MHC (a mutual holding company), and 1,001,210 shares of common stock to the public. As of December 31, 2011, Ottawa Savings Bancorp MHC holds 1,223,701 shares of common stock, representing 57.8% of the Company s common shares outstanding.

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The Bank s business is to attract deposits from the general public and use those funds to originate and purchase one-to-four family, multi-family and non-residential real estate, construction, commercial and consumer loans, which the Bank primarily holds for investment. The Bank has continually diversified its products to meet the needs of the community.

Business Strategy

The Company s business strategy is to operate as a well-capitalized and profitable community savings bank dedicated to providing quality customer service and innovative new products. The Bank operates in a building with 21,000 square feet of office space, five drive-up lanes, and a separate ATM drive-up to provide quality customer service to customers in the community.

Highlights of our business strategy are as follows:

- Continue to emphasize the origination of one-to four-family mortgage loans;
- Aggressively market core deposits;
- Offer a broad range of financial products and services to both retail and commercial customers in the Bank s market area;
- Pursue opportunities to increase non-residential real estate and multi-family lending in the Bank s market area;
- Continue to utilize conservative underwriting guidelines to limit credit risk in the Bank s loan portfolio to achieve a high level of asset quality; and
- Consider expanding into new market areas to grow the Bank s business through the addition of new branch locations and/or through possible acquisitions.

Market Area and Competition

The Company is headquartered in Ottawa, Illinois, which is located in north-central Illinois approximately 80 miles southwest of Chicago. Its market area, which benefits from its proximity to Chicago, includes all of LaSalle County.

The Bank faces significant competition for the attraction of deposits and origination of loans. Our most direct competition for deposits and loans has historically come from the several financial institutions operating in our market area and, to a lesser extent, from other financial service companies, such as brokerage firms, credit unions, mortgage companies and mortgage brokers. Our main competitors include a number of significant independent banks. In addition, the Bank faces competition for investors funds from money market funds and other corporate and government securities. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage and consumer credit market, such as securities companies and specialty finance companies. The Bank believes that its long-standing presence in Ottawa, Illinois and its personal service philosophy enhances its ability to compete favorably in attracting and retaining individual and business customers. The Company actively solicits deposit-related customers and competes for deposits by offering customers personal attention, professional service and competitive interest rates.

Lending Activities

General. Our loan portfolio consists primarily of one-to-four family residential mortgage loans. To a lesser extent, our loan portfolio includes multi-family and non-residential real estate, commercial, construction and consumer loans. Substantially all of our loans are made within LaSalle County.

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Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio by type of loan as of the dates indicated, including a reconciliation of gross loans receivable after consideration of the undisbursed portion of construction loan funds, the allowance for loan losses and net deferred costs (fees).

	At December 31,									
	2011		2010		2009		2008		2007	
	(Dollars in Thousands)									
	Amount	Percent Of Total	Amount	Percent Of Total	Amount	Percent Of Total	Amount	Percent Of Total	Amount	Percent Of Total
One-to-four family	$ 80,334	60.41%	$ 82,442	58.75%	$ 89,595	58.76%	$ 100,057	62.83%	$ 96,571	59.74%
Multi-family	5,580	4.20%	6,237	4.44%	5,512	3.62%	3,809	2.39%	5,542	3.43%
Lines of credit	14,219	10.69%	15,325	10.92%	14,540	9.54%	13,300	8.35%	9,632	5.96%
Non-residential real estate	20,058	15.08%	20,362	14.51%	21,841	14.33%	22,473	14.11%	27,748	17.17%
Commercial	5,965	4.49%	9,795	6.98%	10,528	6.90%	4,367	2.75%	2,600	1.61%
Construction	982	0.74%	531	0.38%	3,858	2.53%	5,158	3.24%	8,138	5.03%
Consumer	5,832	4.39%	5,637	4.02%	6,592	4.32%	10,081	6.33%	11,404	7.06%
Total loans, gross	132,970	100.00%	140,329	100.00%	152,466	100.00%	159,245	100.00%	161,635	100.00%
Undisbursed portion of loan funds	(171)		(178)		(152)		(1,114)		(3,262)	
Allowance for loan losses	(4,747)		(4,703)		(3,515)		(1,605)		(605)	
Deferred loan costs (fees), net	(80)		(97)		(99)		(82)		(66)	
Total loans, net	$ 127,972		$ 135,351		$ 148,700		$ 156,444		$ 157,702	

Listed below are the outstanding balances of purchased loans, which have been included in the table above.

	At December 31,				
	2011	2010	2009	2008	2007
	(In Thousands)				
One-to-four family	$ 754	$ 796	$ 668	$ 703	$ 737
Multi-family	2,405	2,465	1,797	1,821	3,545
Non-residential real estate	3,353	5,399	6,717	7,661	13,203
Consumer	5,179	4,658	5,017	8,067	9,286
Total	$ 11,691	$ 13,318	$ 14,199	$ 18,252	$ 26,771

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Maturity of Loan Portfolio. The following tables show the remaining contractual maturity of our loans at December 31, 2011. The tables do not include the effect of possible prepayments or due on sale clause payments.

	At December 31, 2011							
	One-to-four family	Multi-family	Lines of credit	Non-residential real estate (In Thousands)	Commercial	Construction	Consumer	Total
Amounts due one year or less	$ 669	$	$ 5,560	$ 3,004	$ 43	$ 982	$ 363	$ 10,621
After one year								
More than one year to three years	857	2,412	576	1,906	1,364		1,533	8,648
More than three years to five years	681		768	24	3,138		2,193	6,804
More than five years to ten years	4,728	661	3,596	1,613	750		1,652	13,000
More than ten years to twenty years	24,764	1,490	3,719	7,299	670		91	38,033
More than twenty years	48,635	1,017		6,212				55,864
Total due after December 31, 2012	79,665	5,580	8,659	17,054	5,922		5,469	122,349
Gross Loans Receivable	$ 80,334	$ 5,580	$ 14,219	$ 20,058	$ 5,965	$ 982	$ 5,832	$ 132,970
Less:								
Undisbursed portion of loan funds								(171)
Allowance for loan losses								(4,747)
Deferred loan costs (fees)								(80)
Total loans, net								$ 127,972

	Due After December 31, 2012		
	Fixed	Adjustable (In Thousands)	Total
One-to-four family	$ 39,766	$ 39,899	$ 79,665
Multi-family	1,644	3,936	5,580
Lines of credit		8,659	8,659
Non-residential real estate	4,272	12,782	17,054
Commercial	4,020	1,902	5,922
Consumer	5,469		5,469
Total	$ 55,171	$ 67,178	$ 122,349

Asset Quality. Although we have no subprime or Alt-A loans in our loan portfolio, and no subprime or Alt-A backed issues among our securities, the subprime crisis may affect us indirectly, albeit to a lesser extent than it will likely impact those banks and thrifts that produced and retained significant portfolios of such loans and securities. While we believed that the nature of our one-to-four family lending niche and the conservative nature of our underwriting standards would limit the impact of the downward turn in the credit cycle on the quality of our assets particularly in comparison with those institutions that were involved in subprime and Alt-A lending the downturn in the credit cycle resulted in our experiencing additional charge-offs and/or provisions for loan losses, which impacted our results of operations.

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One- to-Four Family Residential Loans. Our 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 our market area. We offer 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 or purchased at any time is largely determined by the demand for each in a competitive environment and the effect each has on our interest rate risk. The loan fees charged, interest rates, and other provisions of mortgage loans are determined by us on the basis of our own pricing criteria and competitive market conditions.

We offer fixed rate loans with terms of either 15, 20 or up to 30 years. We traditionally sell 30-year fixed rate loans into the secondary market, resulting in a fixed rate loan portfolio primarily composed of loans with less than 15 to 20 year terms. Our adjustable-rate mortgage loans are based on either a 15, 20 or up to 30 year amortization schedule and interest rates and payments on our adjustable-rate mortgage loans adjust every one, three or five years. Interest rates and payments on our adjustable-rate loans generally are adjusted to a rate that is based on the National Monthly Median cost of funds ratio for all Deposit Insurance Fund (DIF)-insured institutions. The maximum amount by which the interest rate may be increased or decreased is generally 1% to 2% per adjustment period, depending on the type of loan, and the lifetime interest rate ceiling is generally 5% over the initial interest rate of the loan. The initial and floor rates for owner occupied properties are 3.25%, 3.75% and 4.25% for the one, three and five year adjustable rate loans, respectively, and 4.25%, 4.75% and 5.25% for non-owner occupied one-to-four family properties, respectively, at this time. The initial and floor rates on multi-family and non-residential properties are generally based on the National Monthly Median cost of funds plus a spread with the initial rate and floor rates ranging from 4.25% to 5.25%, respectively.

Due to historically low interest rate levels, borrowers generally have preferred fixed-rate loans in recent years. While we anticipate that our adjustable-rate loans will better offset the adverse effects on our net interest income of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loans 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 our asset base more responsive to changes in interest rates, the extent of this interest rate sensitivity is limited by the annual and lifetime interest rate adjustment limits.

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 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 and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.

We originate loans to individuals and purchase loans that finance the construction of residential dwellings for personal use. Our construction loans generally provide for the payment of interest only during the construction phase, which is usually ten months. At the end of the construction phase, most of our loans automatically convert to permanent mortgage loans. Construction loans generally can be made with a maximum loan to value ratio of 80% of the appraised value with maximum terms of 30 years. The largest outstanding residential construction loan at December 31, 2011 was $348,000, of which $208,600 was disbursed. We also require periodic inspections of the property during the term of the construction.

We generally do not make conventional loans with loan-to-value ratios exceeding 80%. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance, government guarantee or additional collateral. We require all properties securing mortgage loans to be appraised by an independent appraiser approved by our Board of Directors and licensed by the State of Illinois. We require title insurance on all first mortgage loans. Borrowers must obtain hazard insurance, or flood insurance for loans on property located in a flood zone, before closing the loan.

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We participate with the USDA Rural Development Company to offer loans to qualifying customers. Loans are granted up to 100% of appraised value and the USDA guarantees up to 90% of the loan. These loans require no down payment but are subject to maximum income limitations.

Lines of Credit. We offer lines of credit, principally home equity lines of credit, which have adjustable rates of interest that are indexed to the prime rate as published in *The Wall Street Journal* for terms of up to 15 years. These loans are originated with maximum loan-to-value ratios of 80% of the appraised value of the property, and we require that we have a second lien position on the property. We also offer secured and unsecured lines of credit for well-qualified individuals and small businesses. Management includes these loans based on the collateral supporting the line of credit in either the non-residential, multi-family, commercial or one-to-four family categories for the purposes of monitoring and evaluating the portfolio.

Multi-Family and Non-Residential Real Estate Loans. We offer fixed rate balloon and adjustable-rate mortgage loans secured by multi-family and non-residential real estate. Our multi-family and non-residential real estate loans are generally secured by condominiums, apartment buildings, single-family subdivisions and owner-occupied properties used for businesses.

We originate and purchase multi-family and non-residential real estate loans with terms generally up to 25 years. Interest rates and payments on adjustable-rate loans adjust every one, three and five years. Interest rates and payments on our adjustable rate loans generally are adjusted to a rate typically equal to the interest rate used for one- to- four family loan products, plus 50 basis points to 100 basis points based on credit-worthiness and risk. The adjustment per period is 1% to 2% based on the loan contract, to a lifetime cap of 5%. Loan amounts generally do not exceed 70% of the appraised value for well-qualified borrowers.

We originate and purchase land loans to individuals on approved residential building lots for personal use for terms of up to 15 years and to a maximum loan to value ratio of 80% of the appraisal value. Our land loans are adjustable loans with adjustments occurring every one, three and five years, based on the original contract. Interest rate adjustments are based on the National Monthly Median cost of funds plus a spread. For adjustable loans in this class, the loans generally have a floor ranging from the initial rate up to 5.25%.

We also make non-residential loans for commercial development projects including condominiums, apartment buildings, single-family subdivisions, single-family speculation loans, as well as owner-occupied properties used for business. These loans provide for payment of interest only during the construction phase and may, in the case of an apartment or commercial building, convert to a permanent mortgage loan. In the case of a single family subdivision or construction or builder loan, as individual lots are sold, the principal balance is reduced by a minimum of 80% of the net lot sales price. In the case of a commercial construction loan, the construction period may be from nine months to two years. Loans are generally made to a maximum of 70% of the appraised value as determined by an appraisal of the property made by an independent licensed appraiser. We also require periodic inspections of the property during the term of the construction loan. The largest non-residential loan at December 31, 2011 was $2.2 million, of which $2.2 million was disbursed. For adjustable loans in this category, there generally is an interest rate floor ranging from 3.75% to 6.00%.

Loans secured by multi-family and non-residential 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 non-residential real estate lending is the borrower s credit-worthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income producing 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. In reaching a decision on whether to make a multi-family or non-residential real estate loan, we consider the net operating income of the property, the borrower s expertise, credit history and profitability, and the value of the underlying property.

Commercial Loans. These loans consist of operating lines of credit secured by general business assets and equipment. We loan primarily to businesses with less than $5,000,000 in annual revenues. The operating lines of credit are generally short term in nature with interest rates tied to short term rates and adjustments occurring daily, monthly, or quarterly based on the original contract. For adjustable loans, there is an interest rate floor built in to them ranging from 3.75% to 6.00%. The equipment loans are typically made with maturities of less than five years and are priced with a fixed interest rate. The Bank has originated commercial loans from Bankers Healthcare Group in prior years. Bankers Healthcare Group specializes in loans to healthcare professionals of all specialties throughout the United States. These loans are primarily comprised of working capital and equipment loans. We underwrite these loans based on our criteria and service the loans in-house.

Consumer Loans. We offer a variety of consumer loans, which include auto, share loans and personal unsecured loans to our customer base and related individuals. Unsecured loans generally have a maximum borrowing limit of $25,000 and a maximum term of four years.

The procedures for underwriting consumer loans include an assessment of the applicant s payment history on other debts and ability to meet existing obligations and payments on the proposed loans. Although the applicant s credit-worthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount.

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.

Purchased Auto Loans. The Bank purchases auto loans from regulated financial institutions. At December 31, 2011 and 2010, we had $5.2 million and $4.7 million of loans outstanding, respectively. These types of loans are primarily low balance individual auto loans. We have the opportunity to review the loans at least three days prior to our purchase and we have a right to refuse any specific loan within thirty days of the purchase of any given loan pool. During 2011, we purchased $3.0 million of auto loans.

Loan Origination, Purchases and Sales. Loan originations come from a number of sources. The primary source of loan originations are our in-house loan originators, and to a lesser extent, advertising and referrals from customers. We occasionally purchase loans or participation interests in loans. As of December 31, 2011, we had an aggregate of $11.7 million in purchased loan participations outstanding, including the auto loans purchased as discussed in the previous paragraph. The largest outstanding loan participation as of December 31, 2011 was $1.1 million. This loan is currently in the process of being restructured as of December 31, 2011.

We sell some of the longer-term fixed-rate one-to-four family mortgage loans that we originate in the secondary market 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 goals. Generally, loans are sold without recourse and with servicing retained. We sold $0.6 million and $8.7 million of loans in the years ended December 31, 2011 and 2010, respectively. We occasionally sell participation interests in loans and may sell loan participations in the future.

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The following table shows our loan originations, purchases, sales and repayment activities for the periods indicated.

	For The Years Ended December 31,				
	2011	2010	2009 (In Thousands)	2008	2007
Beginning balance, net	$ 135,351	$ 148,700	$ 156,444	$ 157,702	$ 142,537
Loans originated					
One-to-four family	5,666	19,872	25,587	14,500	21,258
Multi-family	129	562	2,245	518	642
Lines of credit	1,799	530	5,315	2,664	618
Non-residential real estate	4,015	1,085	2,196	2,115	5,771
Commercial	335	8,287	7,738	2,514	2,131
Construction	982	668	710	1,799	8,118
Consumer	190	481	961	1,301	1,577
Total loans originated	13,116	31,485	44,752	25,411	40,115
Loans purchased					
One-to-four family					
Multi-family			4	24	51
Non-residential real estate			895	744	2,348
Commercial					
Consumer	3,050	2,003		1,800	4,420
Total loans purchased	3,050	2,003	899	2,568	6,819
Loan sales (1)	(598)	(8,713)	(14,772)	(2,785)	(3,148)
Principal payments	(22,927)	(36,912)	(37,658)	(27,584)	(29,018)
Change in allowance for loan losses	(44)	(1,188)	(1,910)	(1,000)	(185)
Change in undisbursed loan funds	7	(26)	962	2,148	633
Change in deferred loan costs (fees)	17	2	(17)	(16)	(51)
Ending balance, net	$ 127,972	$ 135,351	$ 148,700	$ 156,444	$ 157,702

(1) All loan sales were one-to-four family loans.

Loan Approval Procedures and Authority. Our lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by our Board of Directors and management.

For one-to-four family loans and owner occupied residential loans, our President may approve loans up to $400,000 and two members of our Board of Directors must approve loans over $400,000. Residential loans and all commercial loans above $400,000 up to $1 million in the aggregate to any borrower(s) must be approved by a majority of our inside loan committee. This committee consists of our President, Vice President and our Commercial Banking Officer. For loans to any borrower(s) in the aggregate of more than $1 million up to $2 million, approval is required by a majority of our level two loan committee, which consists of the inside loan committee, one designated outside director and our Chairman of the Board. For loan requests above $2 million in the aggregate to any borrower(s), approval is required by a majority of the Board of Directors level loan committee, which consists of the inside loan committee and the Bank s Board of Directors as a whole.

Loans to One Borrower. The maximum amount that we may lend to one borrower and the borrower s related entities is limited by regulation to generally 15% of our stated capital and reserves. At December 31, 2011, our regulatory maximum was $3.1 million.

Loan Commitments. We issue 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 our customers and generally expire in 45 days.

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Delinquencies. When a borrower fails to make a required loan payment, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status. We make initial contact with the borrower when the loan becomes 10 days past due. If payment is not then received by the 30th day of delinquency, additional letters are sent and phone calls generally are made to the customer by the Vice President or President. When the loan becomes 60 days past due, we generally commence foreclosure proceedings against any real property that secures the loan or attempt to repossess any personal property that secures a consumer loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan generally is sold at foreclosure. We may consider loan workout arrangements with certain borrowers under certain circumstances.

Management informs the Board of Directors on a monthly basis of the amount of loans delinquent more than 60 days, all loans in foreclosure and all foreclosed and repossessed property that we own.

Delinquent Loans

The following table presents information with respect to the delinquent loans at the dates indicated.

	December 31, 2011					
	60-89 Days		90 Days or More		Total	
	(Dollars in Thousands)					
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
One-to-four family	3	$ 849	25	$ 2,459	28	$ 3,308
Multi-family			1	305	1	305
Lines of credit			7	1,980	7	1,980
Non-residential real estate	1	57	5	709	6	766
Construction						
Commercial			1	7	1	7
Consumer	2	43	2	5	4	48
Total	6	$ 949	41	$ 5,465	47	$ 6,414

	December 31, 2010					
	60-89 Days		90 Days or More		Total	
	(Dollars in Thousands)					
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
One-to-four family	9	$ 1,948	31	$ 3,622	40	$ 5,570
Multi-family						
Lines of credit	4	228	6	401	10	629
Non-residential real estate	2	184	8	1,248	10	1,432
Construction						
Commercial			1	20	1	20
Consumer	3	23			3	23
Total	18	$ 2,383	46	$ 5,291	64	$ 7,674

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	December 31, 2009					
	60-89 Days		90 Days or More (Dollars in Thousands)		Total	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
One-to-four family	11	$ 777	26	$ 3,856	37	$ 4,633
Multi-family						
Lines of credit	2	139	6	248	8	387
Non-residential real estate	2	153	7	2,020	9	2,173
Construction						
Consumer	2	1	3	25	5	26
Total	17	$ 1,070	42	$ 6,149	59	$ 7,219

	December 31, 2008					
	60-89 Days		90 Days or More (Dollars in Thousands)		Total	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
One-to-four family	21	$ 1,550	31	$ 3,534	52	$ 5,084
Multi-family			2	453	2	453
Lines of credit	1	48	5	73	6	121
Non-residential real estate	7	1,550	2	1,188	9	2,738
Construction	1	54			1	54
Consumer	7	70	5	32	12	102
Total	37	$ 3,272	45	$ 5,280	82	$ 8,552

	December 31, 2007					
	60-89 Days		90 Days or More (Dollars in Thousands)		Total	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
One-to-four family	17	$ 1,405	18	$ 1,303	35	$ 2,708
Lines of credit	2	58	6	353	8	411
Non-residential real estate	1	146	3	1,159	4	1,305
Construction	1	204			1	204
Consumer	8	22	9	89	17	111
Total	29	$ 1,835	36	$ 2,904	65	$ 4,739

Classified Assets. Federal Deposit Insurance Corporation regulations and our Asset Classification Policy provide that loans and other assets considered to be of lesser quality be classified as substandard, doubtful or loss assets. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. We classify an asset as special mention if the asset has a potential weakness that warrants management s close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, adversely affecting the repayment of the asset. Loans classified as impaired for financial reporting purposes are generally those loans classified as substandard or doubtful for regulatory reporting purposes.

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An insured institution is required to establish allowances for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as loss, it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount. An institution s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Office of the Comptroller of the Currency (OCC).

On the basis of management s review of its assets, at December 31, 2011 and 2010, we had classified $4.9 million and $8.2 million, respectively, of our assets as special mention and $10.3 million and $15.7 million, respectively, of our assets as substandard. We had classified none of our assets as doubtful at December 31, 2011 and December 31, 2010. There were no assets classified as loss for the years ended December 31, 2011 or 2010. The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all classified assets constitute non-performing assets.

As the economic downturn continued in our market during 2011 and foreclosures and liquidations as a manner of reducing non-performing assets proved costly, the Company initiated a restructuring process with respect to certain non-performing loans that provided for restructuring of the terms of the loan due to economic or legal reasons related to the borrower s financial difficulties. Troubled debt restructurings are considered to be non-performing, except for those that have established a sufficient performance history (generally a minimum of six consecutive months of performance) under the terms for the restructured loan. At December 31, 2011, 15 loans (with aggregate balances of $4.1 million) of our 72 substandard loans (with aggregate balances of $10.3 million) were considered troubled debt restructurings and were included in nonperforming assets. At December 31, 2010, 18 loans (with aggregate balances of $4.9 million) of our 82 substandard loans (with aggregate balances of $15.7 million) were considered troubled debt restructurings and were included in nonperforming assets.

The following table shows the amounts and relevant ratios of nonperforming assets for the periods indicated:

			December 31,		
	2011	2010	2009	2008	2007
			(In Thousands)		
Non-accrual:					
One-to-four family	$ 6,755	$ 4,023	$ 3,856	$ 3,534	$ 1,303
Multi-family	305			453	
Non-residential real estate	1,566	1,248	2,020	1,188	1,159
Commercial	7	20			
Consumer	14		25	32	89
Total non-accrual loans	8,647	5,291	5,901	5,207	2,551
Past due greater than 90 days and still accruing:					
One-to-four family	36				
Lines of credit			248	73	353
Total nonperforming loans	8,683	5,291	6,149	5,280	2,904
Foreclosed real estate	542	1,334	833	95	108
Total nonperforming assets	$ 9,225	$ 6,625	$ 6,982	$ 5,375	$ 3,012

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	December 31,				
	2011	2010	2009	2008	2007
Ratios					
Allowance for loan losses as a percent of gross loans receivable	3.57%	3.35%	2.31%	1.01%	0.37%
Allowance for loan losses as a percent of total nonperforming loans	54.67%	88.89%	57.16%	30.40%	20.83%
Nonperforming loans as a percent of gross loans receivable	6.53%	3.77%	4.03%	3.32%	1.80%
Nonperforming loans as a percent of total assets	4.75%	2.71%	3.06%	2.55%	1.40%
Nonperforming assets as a percent of total assets	5.04%	3.40%	3.48%	2.61%	1.45%

The total amount of non-accrual loans increased to $8.6 million from $5.3 million for the years ended December 31, 2011 and 2010, respectively. Total non-performing loans consist of 58 loans to 31 borrowers. For the years ended December 31, 2011 and 2010, gross interest income of $326,000 and $281,000, respectively, would have been recorded had the non-accrual loans at the end of the period been on accrual status throughout the period. We recognized no interest income on these loans.

Allowance for Loan Losses

Our allowance for loan losses is maintained at a level necessary to absorb loan losses which are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. We utilize a two-tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of our loan portfolio. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Loan impairment is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or, as a practical expedient, at the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. General loan loss allowances are based upon a combination of factors including, but not limited to management s judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings, and offset by recoveries of previously charged-off loans. Loans which are determined to be uncollectible are charged against the allowance. Management uses available information to recognize probable and reasonably estimable loan losses, but future loss provisions may be necessary based on changing economic conditions. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Should full collection of principal be expected, cash collected on nonaccrual loans can be recognized as interest income. The allowance for loan losses as of December 31, 2011 is maintained at a level that represents management s best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable. In addition, the OCC, as an integral part of its examination process, periodically reviews our allowance for loan losses.

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Allowance for Loan Losses. The following table analyzes changes in the allowance for the periods indicated.

	Year Ended December 31,				
	2011	2010	2009	2008	2007
	(Dollars in Thousands)				
Balance at beginning of year	$ 4,703	$ 3,515	$ 1,605	$ 605	$ 420
Charge-offs:					
One-to-four family	1,666	821	360	63	
Multi-family	250				
Non-residential real estate	3,224	952	773		
Commercial		321			
Consumer	43	48	69	105	56
	5,183	2,142	1,202	168	56
Recoveries:					
One-to-four family	1	3	35		
Multi-family			148		2,366
Non-residential real estate	35				
Consumer	11	18	18	4	7
	47	21	201	4	2,373
Net charge-offs (recoveries)	5,136	2,121	1,001	164	(2,317)
Additions charged to operations	5,180	3,309	2,911	1,164	(2,132)
Balance at end of year	$ 4,747	$ 4,703	$ 3,515	$ 1,605	$ 605
Net charge-offs (recoveries) to average gross loans outstanding	3.79%	1.45%	0.64%	0.10%	(1.50)%

Allocation of Allowance for Loan Losses. The following table presents an analysis of the allocation of the allowance for loan losses at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future loss in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	2011		
	Amount	Percent Of Allowance To Total Allowance	Percent Of Gross Loans In Each Category To Total Gross Loans
	(Dollars in Thousands)		
One-to-four family	$ 3,113	65.58%	60.41%
Multi-family	438	9.23%	4.20%
Lines of credit (1)		%	10.69%
Non-residential real estate	1,146	24.14%	15.08%
Commercial	11	0.23%	4.49%
Construction (1)		%	0.74%
Consumer	39	0.82%	4.39%
Total allowance for loan losses	$ 4,747	100.00%	100.00%

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	2010		
	Amount	Percent Of Allowance To Total Allowance	Percent Of Gross Loans In Each Category To Total Gross Loans
	(Dollars in Thousands)		
One-to-four family	$ 2,425	51.56%	58.75%
Multi-family	106	2.25%	4.44%
Lines of credit (1)		%	10.92%
Non-residential real estate	1,880	39.98%	14.51%
Commercial	227	4.83%	6.98%
Construction (1)		%	0.38%
Consumer	65	1.38%	4.02%
Total allowance for loan losses	$ 4,703	100.00%	100.00%

	2009		
	(Dollars in Thousands)		
One-to-four family	$ 2,059	58.58%	58.76%
Multi-family	55	1.57%	3.62%
Lines of credit (1)		%	9.54%
Non-residential real estate	1,193	33.94%	14.33%
Commercial	120	3.41%	6.90%
Construction (1)		%	2.53%
Consumer	88	2.50%	4.32%
Total allowance for loan losses	$ 3,515	100.00%	100.00%

	2008		
	(Dollars in Thousands)		
One-to-four family	$ 504	31.40%	62.83%
Multi-family	47	2.93%	2.39%
Lines of credit (1)		%	8.35%
Non-residential real estate	876	54.58%	14.11%
Commercial	29	1.81%	2.75%
Construction (1)		%	3.24%
Consumer	149	9.28%	6.33%
Total allowance for loan losses	$ 1,605		