TF FINANCIAL CORP
Form 10-K
March 27, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

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

For the fiscal year ended December 31, 2012
or

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

For the transition period from to

Commission file number: 0-24168

TF FINANCIAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	74-2705050
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3 Penns Trail, Newtown, Pennsylvania	18940
(Address of Principal Executive Offices)	(Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $.10 per share	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 o NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

Exchange Act. YES o NO x

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

Indicate by check mark 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). x YES o 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. o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	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 o NO x

The aggregate market value of the voting common equity held by non-affiliates of the registrant, based on the closing price of the registrant's Common Stock as quoted on the Nasdaq System on June 30, 2012, was $48.4 million (1,964,609 shares at $24.66 per share).

As of March 10, 2013 there were outstanding 2,839,931 shares of the registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders for the Fiscal Year Ended December 31, 2012. (Parts I, II and IV)
2. Portions of the Proxy Statement for the 2013 Annual Meeting of Stockholders. (Part III)

PART I

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

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

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

Item 1. Business

BUSINESS OF THE COMPANY

On July 13, 1994, the Company consummated its public offering of 5,290,000 shares of its common stock and acquired 3rd Fed Bank (the "Bank") as part of the Bank's mutual-to-stock conversion. The Company was originally incorporated under Delaware law in March 1994 and subsequently reorganized as a Pennsylvania Corporation in May 2011. In 2011, the Bank elected to convert from a federally-regulated and chartered financial institution to a state-chartered savings bank and submitted an election to remain a savings association for purposes of holding company regulation following the conversion. The Bank received approval for this conversion from the State of Pennsylvania on December 27, 2011. The official charter conversion became effective January 30, 2012. As a result, the name of the Bank was changed from Third Federal Bank to 3rd Fed Bank.

The Company is a savings and loan holding company and is subject to regulation by the Pennsylvania Department of Banking and Securities (the “Department of Banking”), the Board of Governors of the Federal Reserve System (the “FRB”), and the Securities and Exchange Commission (the “SEC”). The Company does not transact any material business other than through its direct and indirect subsidiaries: 3rd Fed Bank, Teragon Financial Corporation, Penns Trail Development Corporation, and Third Delaware Corporation. At December 31, 2012, the Company had total assets of $711.8 million, total liabilities of $628.9 million and stockholders’ equity of $82.9 million.

BUSINESS OF THE BANK

The Bank is a community oriented Pennsylvania-chartered stock savings bank offering a variety of financial services to meet the needs of the communities it serves. The Bank’s deposits are insured up to the maximum amount allowable by the Federal Deposit Insurance Corporation (the “FDIC”).

As of December 31, 2012 the Bank operated thirteen branch offices in Bucks and Philadelphia Counties, Pennsylvania and in Mercer County, New Jersey.

The Bank attracts deposits from the general public and uses such deposits, together with borrowings and other funds primarily to originate or purchase loans secured by first mortgages on owner-occupied, one-to four-family residences in its market area and to invest in mortgage-backed and investment securities. At December 31, 2012, one-to four-family residential mortgage loans totaled $324.4 million or 61% of the Bank's total loan portfolio. At that same date, the Bank had approximately $44.6 million or 6% of total assets invested in mortgage-backed securities and $59.6 million or 8% of total assets in investment securities. The Bank also originates commercial real estate and multi-family, construction and consumer loans.

The Bank has two subsidiaries, Third Delaware Corporation, which was incorporated in 1998 for the purpose of holding and managing mortgage-backed securities and investment securities for the Bank, and Teragon Financial Corporation which holds a 75% limited partnership interest in a captive title insurance agency, Third Fed Abstract, L. P. During 2007, Teragon Financial Corporation was granted approval by the Commonwealth of Pennsylvania to conduct business as an insurance agency.

Pending Acquisition of Roebling Financial Corp, Inc.

On December 28, 2012, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Roebling Financial Corp, Inc. ("Roebling"), the parent company of Roebling Bank, under which the Company will acquire Roebling for approximately $14.5 million in stock and cash.

Under the terms of the Merger Agreement, Roebling will merge with and into the Company (the "Merger") after which Roebling Bank will merge with and into the Bank. Each outstanding share of Roebling common stock will be converted into the right to receive $8.60 per share or 0.364 shares of the Company's common stock, at the election of Roebling shareholders, subject to proration. The aggregate cash consideration to be paid pursuant to the Merger Agreement must not exceed 50% of the total merger consideration (including any cash paid in connection with shares held by the employee stock ownership plan and not allocated to participant accounts). Cash will be paid in lieu of fractional shares at a value based on the average closing sale price of the Company's common stock for the twenty trading days immediately prior to the closing date.

In the event of a greater than 15% decline in market value of the Company's common stock immediately prior to the announcement of the Merger, which percentage decline exceeds any decline in the NASDAQ Bank Index from its starting point by more than 15%, Roebling may be able to terminate the Merger Agreement unless the Company increases the number of shares into which Roebling common stock may be converted.

The Merger is intended to qualify as a tax-free reorganization for federal income tax purposes. As a result, the shares of Roebling exchanged for the Company's shares will be transferred on a tax-free basis. The Merger is expected to close during the second or third quarter of 2013. If the Merger is not consummated under certain circumstances, Roebling has agreed to pay the Company a termination fee of $650,000.

Market Area

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

Competition

The Bank faces varying degrees of competition from banks, thrift institutions and credit unions at its various branch locations. Stronger competition has come from local and very large regional commercial banks based in and around the Philadelphia area. Based upon the latest available data, at June 30, 2012 the Company's share of deposits in each of the counties in which it operates was as follows:

County, State	Market Share for Entire County	Market Share for ZIP Codes Including Company Branches
Philadelphia, Pennsylvania	0.51%	9.66%
Bucks, Pennsylvania	1.45%	4.48%
Mercer, New Jersey	0.75%	6.44%

Lending Activities

General. The Bank’s loan portfolio composition consists primarily of adjustable-rate (“ARM”) and fixed-rate first mortgage loans secured by one-to four-family residences. The Bank also makes commercial real estate and multi-family loans, construction loans and consumer and other loans. At December 31, 2012, the Bank’s mortgage loans outstanding were $486.1 million, of which $324.4 million were secured by first mortgages on one-to four-family residential property. Of the one-to four-family residential mortgage loans outstanding at that date, 14% were ARMs and 86% were fixed-rate loans. At that same date, commercial loans secured by real estate totaled $145.5 million, and construction loans totaled $16.3 million. The construction loans are predominately floating-rate, prime-rate-based loans.

Consumer and other loans held by the Bank totaled $42.0 million or 8% of total loans outstanding at December 31, 2012, of which $40.1 million consisted of home equity and second mortgage loans. At that same date commercial business loans totaled $4.6 million or 1% of total loans.

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

	At December 31,								
	2012		2011		2010		2009		2
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amoun
					(Dollars in thousands)				
Loans receivable:									
Mortgage loans:									
Residential mortgages	$323,665	60.84 %	$277,824	55.44 %	$269,077	52.84 %	$271,651	50.85 %	$281,87
Commercial – real estate secured	145,454	27.34 %	156,450	31.22 %	163,910	32.19 %	168,098	31.46 %	168,23
Construction loans	16,288	3.06 %	16,336	3.26 %	18,799	3.69 %	29,671	5.55 %	30,633
Total mortgage loans	485,407	91.24 %	450,610	89.92 %	451,786	88.72 %	469,420	87.86 %	480,73
Consumer loans:									
Home equity and second mortgage	40,143	7.55 %	44,165	8.81 %	49,430	9.71 %	54,811	10.26 %	56,233
Other consumer	1,835	0.34 %	1,971	0.39 %	2,407	0.47 %	2,565	0.48 %	2,287
Total consumer and other loans	41,978	7.89 %	46,136	9.20 %	51,837	10.18 %	57,376	10.74 %	58,520
Commercial loans:									
Commercial and industrial loans	4,646	0.87 %	4,414	0.88 %	5,575	1.10 %	7,462	1.40 %	8,227
Total commercial-business loans	4,646	0.87 %	4,414	0.88 %	5,575	1.10 %	7,462	1.40 %	8,227
Total loans	532,031	100.00%	501,160	100.00%	509,198	100.00%	534,258	100.00%	547,48
Net of:									
Deferred loan origination costs and unamortized premiums	1,611		1,065		658		609		704
Allowance for loan losses	(6,922)		(8,100)		(8,328)		(5,215)		(3,855
Total loans, held for investment, net	$526,720		$494,125		$501,528		$529,652		$544,33
Loans held for sale:									
Mortgage loans:									
Residential mortgages	$706	100.00%	$488	100.00%	$130	100.00%	$1,082	100.00%	$1,659
Total loans held for sale	$706	100.00%	$488	100.00%	$130	100.00%	$1,082	100.00%	$1,659
Mortgage-backed securities held to maturity:									
Federal Home Loan Mortgage Corporation (“FHLMC”)	$342	17.40 %	$449	17.35 %	$566	17.86 %	$754	20.20 %	$1,100
Federal National Mortgage Association (“FNMA”)	895	45.55 %	1,242	47.99 %	1,489	46.99 %	1,698	45.49 %	2,141

Government National Mortgage Association (“GNMA”)	728	37.05 %	897	34.66 %	1,114	35.15 %	1,281	34.31 %	1,533
Total mortgage-backed securities held to maturity	$1,965	100.00 %	$2,588	100.00 %	$3,169	100.00 %	$3,733	100.00 %	$4,774
Mortgage-backed securities available-for-sale:									
FHLMC	$2,159	5.06 %	$3,586	6.36 %	$2,355	3.54 %	$3,440	4.40 %	$4,504
FNMA	30,001	70.30 %	23,454	41.60 %	9,734	14.64 %	9,146	11.70 %	12,320
GNMA	726	1.70 %	1,140	2.02 %	1,637	2.46 %	1,886	2.41 %	—
Real estate investment mortgage conduit ("REMICs")	9,788	22.94 %	28,202	50.02 %	52,765	79.36 %	63,726	81.49 %	90,393
Total mortgage-backed securities available for sale	$42,674	100.00 %	$56,382	100.00 %	$66,491	100.00 %	$78,198	100.00 %	$107,21

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Loan Maturity and Repricing Information. The following table sets forth certain information at December 31, 2012, regarding the dollar amount of loans maturing in the Bank's loan portfolio based on their maturity date. Demand loans, loans having no stated schedule of repayments and no stated maturity, overdrafts and delinquent loans maturing prior to December 31, 2012 are reported as due in one year or less. The table does not include prepayments or scheduled principal repayments.

	Due 1/1/13 - 12/31/13	Due 1/1/14 - 12/31/17 (In thousands)	Due After 12/31/17
Loans held for sale:			
Residential mortgages	$—	$ —	$706
Total loans held for sale	$—	$ —	$706
Loans receivable:			
Residential mortgages	$243	$ 7,743	$315,679
Commercial – real estate secured	15,277	5,902	124,275
Construction loans	16,288	—	—
Consumer and other	159	3,725	38,094
Commercial and industrial loans	988	1,245	2,413
Total loans receivable	$32,955	$ 18,615	$480,461

The following table sets forth the dollar amount of all loans due after December 31, 2013, which have predetermined interest rates and which have floating or adjustable interest rates. Loans which have rate adjustments after ten years are considered to have predetermined rates.

	Predetermined Rates	Floating or Adjustable Rate
	(In thousands)	
Loans held for sale:		
Residential mortgages	$706	$ —
Total loans held for sale	$706	$ —
Loans receivable:		
Residential mortgages	$275,616	$ 47,806
Commercial – real estate secured	18,325	111,852
Consumer and other	21,098	20,721
Commercial and industrial loans	3,479	179
Total loans receivable	$318,518	$ 180,558

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

Loan originations are obtained through the Bank's retail banking channels, the local community, and referrals from established builders and realtors within the Bank's lending area using direct advertising in local newspapers, branch signage and promotions, and word of mouth referrals. The Bank also has a mortgage lending department that is separate as to its sales efforts from the consumer lending department of the Bank. This department employs a lending manager and several commissioned loan officers. The mortgage loan officers support the Bank's branches and customers, and additionally engage in calling efforts directed toward realtors, builders, other loan originators and others that can be sources of lending business for the Bank.

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

The Bank offers fixed-rate mortgage loans with terms of 10 to 30 years, which are payable monthly. Interest rates charged on fixed-rate mortgage loans are competitively priced based on market conditions. The origination fees for fixed-rate loans range from 0% to 3% depending on the underlying loan coupon. Generally, the Bank’s standard underwriting guidelines for fixed-rate mortgage loans conform to FNMA guidelines.

The Bank sells a portion of its conforming fixed-rate mortgage loan originations in the secondary market to FNMA while retaining the servicing rights on these loans. As of December 31, 2012, the Bank’s portfolio of loans serviced for FHLMC or FNMA totaled approximately $127.9 million. The Bank also brokers a small portion of its loan closings to correspondents on a servicing released basis. However, the Bank is primarily a portfolio lender.

Commercial Lending. The Bank originates permanent loans secured by commercial real estate including non-owner occupied residential, multi-family dwelling units, professional office buildings and hotels/motels. The Bank generally originates commercial real estate and multi-family loans up to 75% of the appraised value of the property securing the loan. Currently, it is the Bank’s practice to originate commercial real estate and multi-family loans primarily on properties in its general market area. The commercial real estate and multi-family loans in the Bank’s portfolio consist of fixed-rate, ARM and balloon loans originated at prevailing market rates for terms of up to 25 years, and typically either have a scheduled interest rate reset or are callable by the Bank after a 5 to 10 year period.

Loans secured by commercial and multi-family real estate are generally larger and involve a greater degree of risk than one-to four-family residential mortgage loans. Of primary concern in commercial and multi-family real estate lending is the feasibility and cash flow potential of the project and the borrower’s creditworthiness. Loans secured by income properties are generally larger and involve greater risks than residential mortgage loans because payments on loans secured by income properties are often dependent on successful operation or management of the properties. As a result, repayment of such loans may be impacted to a greater extent by adverse conditions in the real estate market or the economy than residential real estate loans. In order to monitor cash flows on income properties, the Bank requires borrowers and loan guarantors, if any, to provide annual financial statements and rent rolls on multi-family loans. Similarly, on commercial office buildings and hotel properties, the Bank requires minimum debt service coverage and obtains operating statements of such properties. At December 31, 2012, the five largest commercial real estate and multi-family loans totaled $26.0 million with no single loan larger than $7.8 million.

Construction and Land Acquisition Lending. At December 31, 2012, the Bank’s construction and land acquisition loans were $16.3 million or 3% of the Bank’s total loan portfolio. Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property’s value at completion of construction or development and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the construction. If the estimate of value proves to be inaccurate, the Bank may be confronted, at or prior to the maturity of the loan, with a project having a value which is insufficient to assure full repayment. Land acquisition lending is susceptible to the risks of obtaining necessary approvals and permits, and the feasibility of the project once such approvals are obtained. At December 31, 2012, the five largest construction and land acquisition loans totaled $14.9 million with no single loan larger than $6.0 million.

Consumer and Other Loans. The Bank also offers consumer and other loans in the form of home equity and second mortgage loans (referred to hereinafter collectively as “second mortgage loans”), automobile loans and student loans. These loans totaled $42.0 million or 8% of the Bank’s total loan portfolio at December 31, 2012. The Bank originates consumer loans through its retail banking channel and mortgage loan department.

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

Consumer loans tend to be originated at higher interest rates than conventional residential mortgage loans and for shorter terms, thus facilitating the Bank’s interest rate risk management. Consumer loans can have a higher risk of default than residential mortgage loans. However, at December 31, 2012, $0.2 million or 1% of the Bank’s consumer loans were delinquent more than 90 days, compared to $2.2 million or 1% of residential one-to four-family loans.

The Bank offers second mortgage loans on one-to four-family residences. At December 31, 2012, second mortgage and home equity loans totaled $40.1 million, or 8% of the Bank's total loan portfolio. Second mortgage loans are offered as fixed-rate loans for a term not to exceed 15 years or prime-rate-based floating rate loans with amortization periods up to 15 years and in some cases, an interest-only period of up to the first 60 months of the loan term. Such loans are only made on owner-occupied one-to four-family residences and are subject to a 90% combined loan to value ratio. The underwriting standards for second mortgage loans are the same as the Bank's standards applicable to one-to four-family residential loans.

Commercial and Industrial Loans. The Bank makes commercial business loans predominantly on a secured or guaranteed basis. The terms of these loans generally do not exceed five years. These loans can have floating interest rates which adjust with changes in market interest rates, usually the prime rate, or have a fixed rate related to their term to maturity. The Bank's commercial business loans primarily consist of short-term loans for equipment, working capital, business expansion, interim financing for the purchase of income-producing property and inventory financing, and may not be real estate secured.

The Bank customarily requires a personal guaranty of payment by the principals of any borrowing entity and reviews the financial statements and income tax returns of the guarantors. At December 31, 2012, the Bank had approximately $4.6 million outstanding in commercial business loans, which represented approximately 1% of its total loan portfolio. At December 31, 2012, the five largest commercial business loans totaled $3.4 million with no single loan larger than $1.5 million.

Loan Approval Authority and Underwriting. The Board of Directors of the Bank sets the authority to approve loans based on the amount, type of loan (i.e., secured or unsecured) and total exposure to the borrower. Where there are one or more existing loans to a borrower, the level of approval required is governed by the proposed total exposure including the new loan. The Board has approved loan authority and limits for certain of the Bank's lending personnel and senior officers, including the president of the Bank. Individual approval authority ranges from $125,000 to $750,000 for secured loans, and $25,000 to $100,000 for unsecured loans. Members of an in-house loan committee including four senior members of management can approve in certain combinations all loans over $750,000 up to $2.0 million. The committee has the authority to approve secured loans up to $2.0 million and unsecured loans up to $200,000. Secured loans greater than $2.0 million through $5.0 million and unsecured loans greater than $200,000 through $5.0 million require the approval of the Director's Board Loan Committee composed of four members of the Board of Directors of the Bank. All loans over $5 million or loans that cause the aggregate lending relationship to exceed $5.0 million must be approved by the Bank's Board of Directors.

One-to four-family residential mortgage loans are generally underwritten according to FNMA guidelines. For all loans originated by the Bank, upon receipt of a completed loan application from a prospective borrower, a credit report is obtained, income and certain other information is verified and, if necessary, additional financial information may be required. The Bank does not engage in sub-prime, stated income or "no-doc" style portfolio lending. An appraisal of the real estate intended to secure the proposed loan is required and is performed by an independent appraiser designated and approved by the Bank. The Bank makes construction/permanent loans on individual properties. Funds advanced during the construction phase are held in a loan-in-process account and disbursed based upon various stages of completion. An independent appraiser or loan officer determines the stage of completion based upon a physical inspection of the construction and funds are advanced only for work in place. It is the Bank's policy to obtain title insurance or a title opinion on all real estate first mortgage loans in excess of $500,000. Borrowers must also obtain hazard or flood insurance (for loans on property located in a flood zone) prior to closing the loan.

Loans to One Borrower. Under applicable Pennsylvania and federal law, the Bank has, subject to certain exemptions, a lending limit to one borrower in an amount equal to 15% of the Bank's capital account. In addition, the Bank may extend credit to a single borrower secured by federal and state securities and other specified collateral in an amount up to 15% of its capital account. A Pennsylvania bank's capital account includes the aggregate of all capital, surplus, undivided profits, capital securities, and general reserves for loan losses. The Bank's maximum loan-to-one borrower limit was approximately $12.1 million as of December 31, 2012 and the Bank's five largest aggregate lending relationships pursuant to the loans to one borrower regulations had balances ranging from $6.4 to $8.7 million.

Mortgage-Backed Securities

To supplement lending activities, the Bank invests in residential mortgage-backed securities. The majority of such securities are classified as available for sale. In addition, they serve as collateral for borrowings and, through repayments, are a source of liquidity.

The mortgage-backed securities portfolio as of December 31, 2012, consisted of pass-through certificates issued by the FHLMC ($2.5 million), GNMA ($1.5 million), FNMA ($30.9 million), and REMICs formed from pass-through certificates issued by these same agencies ($9.8 million).

At December 31, 2012, the amortized cost of mortgage-backed securities totaled $43.2 million, or 6% of total assets, and the fair value of such securities totaled approximately $44.9 million.

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

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

	At December 31,		
	2012	2011	2010
	(In thousands)		
Held to maturity:			
GNMA-fixed rate	$728	$897	$1,114
FHLMC ARMs	5	9	14
FHLMC-fixed rate	337	440	552
FNMA-fixed rate	895	1,242	1,489
Total mortgage-backed securities held to maturity	$1,965	$2,588	$3,169
Available-for-sale:			
GNMA-fixed rate	$726	$1,140	$1,637
FHLMC-fixed rate	2,159	3,586	2,355
FNMA-fixed rate	30,001	23,454	9,734
REMICs-fixed rate	9,788	28,202	52,765
Total mortgage-backed securities available for sale	$42,674	$56,382	$66,491

Mortgage-Backed Securities Maturity. The following table sets forth the maturity and the weighted average coupon ("WAC") of the Bank's mortgage-backed securities portfolio at December 31, 2012. The table does not include estimated prepayments. Adjustable-rate mortgage-backed securities are shown as maturing based on contractual maturities.

Contractually Due	Held to Maturity	WAC		Available for Sale	WAC	
	(Dollars in thousands)					
Less than 1 year	$—	—	%	$347	4.83	%
1 to 3 years	—	—	%	2,098	5.10	%
3 to 5 years	20	6.96	%	—	—	%
5 to 10 years	218	4.96	%	9,642	3.72	%
10 to 20 years	1,727	6.36	%	22,110	3.38	%
Over 20 years	—	—	%	8,477	4.38	%
Total mortgage-backed securities	$1,965	6.21	%	$42,674	3.75	%

Nonperforming and Problem Assets

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

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

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

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

	At December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Loans accounted for on a nonaccrual basis:					
Residential mortgages	$2,265	$5,502	$3,618	$1,117	$780
Commercial – real estate secured	1,149	2,711	9,594	2,506	1,356
Construction loans	4,794	4,044	4,307	4,554	3,017
Consumer and other	151	278	1,415	107	126
Commercial and industrial loans	—	6	44	—	—
Total nonaccrual loans	8,359	12,541	18,978	8,284	5,279
Real estate owned, net	7,282	11,730	7,482	1,279	—
Total nonperforming assets	$15,641	$24,271	$26,460	$9,563	$5,279
Total nonaccrual loans to loans	1.56 %	2.49 %	3.72 %	1.55 %	0.96 %
Total nonaccrual loans to total assets	1.17 %	1.84 %	2.74 %	1.16 %	0.72 %
Total nonperforming assets to total assets	2.20 %	3.56 %	3.82 %	1.34 %	0.72 %

Nonperforming commercial real estate loans include a loan with an unpaid principal balance of $1.5 million secured by two contiguous parcels of commercial real estate and a lien on the guarantor’s personal residence. The Bank has recorded a partial charge-off of $951,000 from the allowance for loan losses, equal to the difference between the loan balance and the fair value based upon a recent appraisal. The Bank has initiated foreclosure proceedings and the borrower has filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. Additionally, $296,000 of the allowance for loan losses has been allocated to this loan for potential acquisition or selling costs related to the properties.

Nonperforming construction loans also include two loans, with a combined balance of $2.0 million secured by a parcel of land. The Bank has recorded a partial charge-off of $202,000 from the allowance for loan losses equal to the difference between the recorded investment and a recent appraisal. The borrower is attempting to sell the property and intends to apply the sale proceeds to the outstanding loan balance. Additionally, $29,000 of the allowance for loan losses has been allocated to this loan for potential acquisition or selling costs related to the property.

Nonperforming construction loans also include a participation in a commercial construction project with a principal balance due to the Bank of $3.1 million. The Bank has recorded a partial charge-off of $198,000 from the allowance for loan losses equal to the difference between the recorded investment and a recent appraisal. Additionally, $1,000,000 of the allowance for loan losses has been allocated to this loan for a potential shortfall related to the disposition of the loan.

With respect to each of the remaining nonperforming loans, the Bank is taking appropriate steps to resolve the individual situations.

The Bank was not aware of any other significant potential problem loans. “Potential problem loans” are loans where information about possible credit problems of borrowers has caused management to have serious doubts about the borrowers’ ability to comply with present repayment terms.

At December 31, 2012, the Bank had no foreign loans and no loan concentrations exceeding 10% of total loans. “Loan concentrations” are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions.

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

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

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

Although the allowance has been determined based on loan class, the total allowance is available to absorb any and all losses from any class of the loan portfolio. At December 31, 2012, management believes that the allowance for loan losses is at an acceptable level.

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

	For the Years Ended December 31,				
	2012	2011	2010	2009	2008
	(Dollars in thousands)				
Balance at beginning of period	$8,100	$8,328	$5,215	$3,855	$2,842
Provision for loan losses	2,400	3,728	4,241	2,930	1,500
Charge-offs:					
Residential mortgages	(768)	(172)	(49)	(149)	(12)
Commercial – real estate secured	(1,438)	(2,041)	(831)	(278)	—
Construction loans	(1,182)	(1,521)	(59)	(1,092)	(347)
Consumer and other	(116)	(237)	(53)	(88)	(55)
Commercial and industrial loans	(156)	(44)	(146)		