EFC BANCORP INC
Form 10-K
March 17, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2004

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: 1-13605

EFC BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-4193304**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification no.)
1695 Larkin Avenue, Elgin, Illinois	**60123**
(Address of principal executive offices)	(Zip code)

Registrant s telephone number, including area code: **(847) 741-3900**

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 $.01 per share	**The American Stock Exchange**
(Title of Class)	(Name of each Exchange on which registered)

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 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 ý No o

Indicate by check mark if disclosure of delinquent filers in response 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 Park III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes o No ý

The aggregate market value of voting stock held by non-affiliates of the registrant, i.e., persons other than directors and executive officers of the registrant was $73,300,000 based upon the average bid and asked price of such common equity as of the last business day of registrant s most recently completed second fiscal quarter.

The number of shares of Common Stock outstanding as of March 7, 2005 is 4,759,513.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Annual Report and Proxy Statement for the 2005 Annual Meeting of Stockholders are incorporated by reference into Part II and III of this Form 10-K.

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PART I

Item 1. Business.

General

EFC Bancorp, Inc. (also referred to as the Company or Registrant), was incorporated under Delaware law in October 1997. The Registrant was formed to acquire Elgin Financial Savings Bank and subsidiaries, Elgin, Illinois, (the Bank) as part of the Bank s conversion from a mutual to a stock form of organization (the Conversion). In connection with the Conversion, the Company issued an aggregate of 7,491,434 shares of its common stock, par value $0.01 per share (Common Stock) at a purchase price of $10 per share, of which 6,936,513 shares were issued in a subscription offering and 554,921 shares were issued to the Elgin Financial Foundation (the Foundation), now known as EFS Foundation, a charitable foundation established by the Bank. The Company received approval to become a savings and loan holding company and is subject to regulation by the Office of Thrift Supervision (OTS) and the Securities and Exchange Commission (SEC). The Company s acquisition of the Bank occurred on April 3, 1998.

The Bank is a community-oriented savings institution that was originally organized in 1924 as a federally-chartered mutual savings and loan association. The Bank reorganized in the 1980s to become Elgin Federal Financial Center, a federally-chartered mutual savings association, and again in 1996 to become Elgin Financial Center, S.B., an Illinois state-chartered mutual savings bank. In 1998, the Bank changed its name to Elgin Financial Savings Bank. Most recently, in October 2002 the Bank changed its name to EFS Bank. The Bank s principal business consists of the acceptance of retail deposits from the general public in the areas surrounding its full-service branch offices and the investment of those deposits, together with funds generated from operations and borrowings, primarily in one- to four-family residential mortgage loans and, to a lesser extent, multi-family and commercial real estate loans, construction and land loans, commercial business loans, home equity loans, and automobile and passbook savings loans. The Bank generally originates all of its loans for investment. The Bank also invests primarily in government insured or guaranteed mortgage-backed securities, U.S. Government obligations and municipal securities. The Bank s revenues are derived principally from the interest on its mortgage, consumer and commercial business loans and securities and from servicing fees. The Bank s primary sources of funds are retail savings deposits and, to a lesser extent, advances from the Federal Home Loan Bank of Chicago (the FHLB-Chicago).

Market Area

Headquartered in largely suburban Kane County, Illinois, the Bank has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services to meet the needs of the communities it serves. The Bank currently operates four full-service banking facilities in Elgin and five full service facilities located in West Dundee, East Dundee, Huntley, Carpentersville and St. Charles, Illinois. The Bank s primary lending and deposit gathering area is concentrated around the areas where its full-service banking facilities are located which the Bank generally considers to be its primary market area.

Elgin is located on U.S. Interstate 90 (the Northwest tollway) in the Fox River Valley approximately 38 miles northwest of downtown Chicago and 25 miles west of O Hare International Airport. Interstate 90 provides easy access to the City of Chicago and is a major corridor of suburban growth for Chicago. The economy in the Bank s primary market area has historically benefited from the growth of the Chicago suburbs into Kane, Western Cook and McHenry Counties with an influx of new residents and employers. Other employment and economic activity is provided by a variety of wholesale and retail trade, hospitals and a riverboat gambling facility located on the Fox River in Elgin.

Competition

The Bank faces significant competition both in making loans and in attracting deposits. The State of Illinois has a high density of financial institutions, many of which are branches of significantly larger institutions, which have greater financial resources than the Bank, all of which are competitors of the Bank to varying degrees. The Bank s competition for loans comes principally from savings banks, savings and loan associations, commercial banks, mortgage banking companies, credit unions, insurance companies and other financial service companies. Its most direct competition for deposits has historically come from

savings and loan associations, savings banks, commercial banks and credit unions. The Bank faces additional competition for deposits from non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies. Competition may also increase as a result of the lifting of restrictions on the interstate operations of financial institutions. There are approximately 21 financial institutions with operations in Elgin and approximately 51 financial institutions with operations in the Bank s primary market area.

Lending Activities

Loan Portfolio Composition. The types of loans that the Bank may originate are subject to federal and state laws and regulations. Interest rates charged by the Bank on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and the rates offered by its competitors. These factors are, in turn, affected by general and economic conditions, monetary policies of the federal government, including the Federal Reserve Board (FRB), legislative tax policies and governmental budgetary matters.

The Bank s loan portfolio primarily consists of first mortgage loans secured by one- to four-family residences most of which are located in its primary market area. At December 31, 2004, the Bank s gross loan portfolio totaled $812.5 million, of which $503.8 million were one- to four-family residential mortgage loans, or 62.0% of total loans. At such date, the remainder of the loan portfolio consisted of $55.3 million of multi-family loans, or 6.8% of total loans; $131.0 million of commercial real estate loans, or 16.1% of total loans; $44.1 million of construction and land loans, or 5.4% of total loans; $39.4 million of commercial loans, or 4.9% of total loans; and $39.0 million of consumer loans, or 4.8% of total loans, consisting of $31.7 million of home equity lines of credit, $5.6 million of secured and unsecured personal loans and $1.7 million of automobile loans. The Bank sold loans totaling $42.7 million and $20.8 million during the years ended December 31, 2004 and December 31, 2003, respectively. At December 31, 2004, 53.0% of the Bank s mortgage loans had adjustable interest rates, most of which were indexed to the one year Constant Maturity Treasury (CMT) Index.

The following table sets forth the composition of the Bank s loan portfolio in dollar amounts and in percentages of the respective portfolios at the dates indicated.

	At December 31,									
	2004		2003		2002		2001		2000	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)									
Mortgage loans:										
One- to four-family	$ 503,755	62.0%	$ 466,931	64.8%	$ 405,953	67.6%	$ 375,452	69.6%	$ 326,739	70.7%
Multi-family	55,269	6.8	52,249	7.3	42,498	7.1	58,093	10.8	50,965	11.0
Commercial real estate	131,043	16.1	109,426	15.2	52,155	8.7	42,813	7.9	29,729	6.5
Construction and land	44,121	5.4	36,356	5.0	41,323	6.9	16,285	3.0	16,025	3.5
Total mortgage loans	734,188	90.3	664,962	92.3	541,929	90.3	492,643	91.3	423,458	91.7
Other loans:										
Home equity loans	31,654	3.9	27,497	3.8	21,160	3.5	14,689	2.7	11,972	2.6
Commercial	39,416	4.9	22,603	3.1	33,315	5.6	30,046	5.6	25,240	5.5
Auto loans	1,693	.2	1,471	.2	1,116	.2	764	.1	615	.1
Loans on savings accounts	284		229		1,017	.1	335	.1	216	
Other	5,291	.7	4,066	.6	1,889	.3	1,160	.2	455	.1
Total other loans	78,338	9.7	55,866	7.7	58,497	9.7	46,994	8.7	38,498	8.3
Total loans receivable	812,526	100.0%	720,828	100.0%	600,426	100.0%	539,637	100.0%	461,956	100.0%
Less:										
Deferred loan fees, net	196		190		247		311		280	
Allowance for loan losses	4,496		3,754		3,141		2,255		1,881	
Loans receivable, net	$ 807,834		$ 716,884		$ 597,038		$ 537,071		$ 459,795	

Loan Originations. The Bank s mortgage lending activities are conducted by its loan personnel operating at its nine branch offices as well as through participation and loan acquisition programs. All loans originated by the Bank are underwritten by the Bank pursuant to the Bank s policies and procedures. The Bank originates both adjustable-rate and fixed-rate mortgage loans, commercial loans, and consumer loans. The Bank s ability to originate fixed- or adjustable-rate loans is dependent upon the relative customer demand for such loans, which is affected by the current and expected future level of interest rates. It is the general policy of the Bank to retain loans originated in its portfolio.

During the years ended December 31, 2004 and 2003, the Bank originated $12.0 million and $93.6 million of fixed-rate one- to four-family residential mortgage loans, respectively, and for the years ended December 31, 2004 and 2003, the Bank originated $84.2 million and $62.5 million of adjustable-rate one- to four-family residential mortgage loans, respectively, all of which were retained by the Bank. Based upon the Bank s investment needs and market opportunities, the Bank participates and purchases loans, consisting of one-to-four family, multi-family and commercial real estate mortgage loans, and construction loans secured by property located in Illinois, southern Wisconsin and, to a lesser extent, in Minnesota, and had $192.2 million of purchased loan participation interests at December 31, 2004.

The following tables set forth the Bank s loan originations, purchases and principal repayments for the periods indicated. All loans originated by the Bank are generally held for investment.

	For the Year Ended December 31, (In thousands)		
	2004	**2003**	**2002**
Gross loans (1):			
Balance outstanding at beginning of period	$ 720,828	$ 600,426	$ 539,637
Loans originated (2):			
One-to four-family residential	96,202	156,087	103,136
Multi-family	13,957	3,537	7,015
Commercial real estate	46,681	76,666	4,111
Construction and land	59,526	19,383	31,023
Home equity	24,756	27,402	18,240
Commercial business	49,985	8,915	9,102
Auto loans	807	1,016	881
Loans on savings accounts	247	221	1,141
Other	9,991	6,333	4,535
Total loans originated	302,152	299,560	179,184
Loans purchased	75,815	110,231	79,620
Total loans originated and purchased	377,967	409,791	258,804
Less:			
Principal repayments	(240,682)	(268,417)	(178,008)
Loans sold	(42,693)	(20,838)	(13,217)
Transfers to real estate owned			(1,986)
Change in loans in process	(2,894)	(134)	(4,804)
Total loans receivable at end of period	$ 812,526	$ 720,828	$ 600,426

(1) Gross loans exclude unearned discounts, deferred loan fees and the allowance for loan losses.

(2) Amounts for each period include loans in process at period end.

Loan Maturity and Repricing. The following table shows the contractual maturity of the Bank s loan portfolio at December 31, 2004. The table does not include prepayments, scheduled principal amortization or repricing of adjustable rate loans. Prepayments and scheduled principal amortization on mortgage loans totaled $240.7 million, $268.4 million and $178.0 million for the years ended December 31, 2004, 2003 and 2002, respectively.

	At December 31, 2004									
	One- to Four-Family	**Multi-Family**	**Commercial Real Estate**	**Construction and Land**	**Home Equity**	**Commercial Business**	**Auto Loans**	**Loans on Savings Accounts**	**Other**	**Total Loans Receivable**
					(In thousands)					
Amounts due:										
Within one year	$ 6,531	$ 5,450	$ 8,758	$ 13,111	$ 1,333	$ 25,500	$ 39	$ 232	$ 3,827	$ 64,781
After one year:										
More than one year to three years	11,916	10,602	27,361	25,430	2,562	1,533	1,249	52	313	81,018
More than three years to five years	20,488	14,805	69,039	2,632	1,097	11,424	393		320	120,198
More than five years to 10 Years	14,038	12,267	17,568	2,840	7,980	959	12		99	55,763
More than 10 years to 20 Years	120,254	2,885	6,721	108	18,682				732	149,382
More than 20 years	330,528	9,260	1,596							341,384
Total due after December 31, 2005	497,224	49,819	122,285	31,010	30,321	13,916	1,654	52	1,464	747,745
Total amount due (gross)	$ 503,755	$ 55,269	$ 131,043	$ 44,121	$ 31,654	$ 39,416	$ 1,693	$ 284	$ 5,291	812,526
Less:										
Deferred loan fees, net										196
Allowance for loan losses										4,496
Total loans, net										$ 807,834

The following table sets forth at December 31, 2004, the dollar amount of gross loans receivable contractually due after December 31, 2005, and whether such loans have fixed interest rates or adjustable interest rates.

	Due After December 31, 2005		
	Fixed	**Adjustable**	**Total**
		(In thousands)	
Mortgage loans:			
One- to four-family	$ 217,212	$ 280,012	$ 497,224
Multi-family	30,920	18,899	49,819
Commercial real estate	77,345	44,940	122,285
Construction and land	4,443	26,567	31,010
Total mortgage loans	329,920	370,418	700,338
Home equity		30,321	30,321
Commercial	8,465	5,451	13,916
Auto loans	1,654		1,654
Loans on savings accounts	52		52
Other	929	535	1,464
Total loans	$ 341,020	$ 406,725	$ 747,745

One- to Four-Family Lending. The Bank currently offers both fixed-rate and adjustable-rate mortgage (ARM) loans with maturities up to 30 years secured by one- to four-family residences which are generally located in the Bank s primary market area. One- to four-family mortgage loan originations are generally obtained from the Bank s in-house loan representatives,

mortgage brokers, from existing or past customers, through advertising, and through referrals from local builders, real estate brokers and attorneys. At December 31, 2004, the Bank s one- to four-family mortgage loans totaled $503.8 million, or 62.0%, of total loans. Of the one- to four-family mortgage loans outstanding at that date, 47.1% were fixed-rate mortgage loans and 52.9% were ARM loans.

The Bank currently offers fixed-rate mortgage loans with terms from 10 to 30 years. These loans have generally been priced at current market rates for such loans. The Bank currently offers a number of ARM loans with terms of up to 30 years and interest rates which adjust every one, two or three years from the outset of the loan or which adjust annually after a two, three or five year initial fixed period. The interest rates for the Bank s ARM loans are indexed to the one-year CMT Index. The Bank originates ARM loans with initially discounted rates, often known as teaser rates. The Bank s ARM loans generally provide for periodic (not more than 2%) and overall (not more than 6%) caps on the increase or decrease in the interest rate at any adjustment date and over the life of the loan. However, interest rates on the Bank s residential ARM loans may never adjust to be less than the initial rate of interest charged on any such loan.

The origination of adjustable-rate residential mortgage loans, as opposed to fixed-rate residential mortgage loans, helps reduce the Bank s exposure to increases in interest rates. However, adjustable-rate loans generally pose credit risks not inherent in fixed-rate loans, primarily because as interest rates rise, the underlying payments of the borrower rise, thereby increasing the potential for default. Periodic and lifetime caps on interest rate increases help to reduce the risks associated with adjustable-rate loans but also limit the interest rate sensitivity of such loans.

The Bank has also purchased one-to-four family first mortgage loans generally out of our primary market area. As of December 31, 2004, the Bank had $123.1 million of these loans. In addition, the Bank sold loans totaling $42.7 million and $20.8 million for the years ended December 31, 2004 and 2003, respectively.

Multi-Family and Commercial Real Estate Lending. The Bank originates multi-family and commercial real estate loans that are generally secured by five or more unit apartment buildings and properties used for business purposes such as small office buildings or retail facilities located in the Bank s primary market area. The Bank s multi-family and commercial real estate underwriting policies provide that such real estate loans may be made in amounts up to 80% of the appraised value of the property, subject to the Bank s current loans-to-one-borrower limit, which at December 31, 2004 was $20.9 million. The Bank s multi-family and commercial real estate loans may be made with terms up to 25 years and are offered with interest rates that adjust periodically. In reaching its decision on whether to make a multi-family or commercial real estate loan, the Bank considers the net operating income of the property, the borrower s expertise, credit history and profitability and the value of the underlying property. The Bank has generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x. Environmental impact surveys are generally required for all commercial real estate loans. Generally, all multi-family and commercial real estate loans made to corporations, partnerships and other business entities require personal guarantees by the principals. On an exception basis, the Bank may not require a personal guarantee on such loans depending on the creditworthiness of the borrower and the amount of the down payment and other mitigating circumstances. The Bank continues to emphasize commercial real estate lending. The Bank s multi-family real estate loan portfolio at December 31, 2004 was $55.3 million, or 6.8% of total loans, and the Bank s commercial real estate loan portfolio at such date was $131.0 million, or 16.1% of total loans. This compares to $52.2 million and $109.4 million at December 31, 2003, respectively. The largest multi-family or commercial real estate loan in the Bank s portfolio (excluding loan participation interests) at December 31, 2004 was a $6.4 million performing commercial real estate loan secured by commercial type property located in Elgin, Illinois.

The Bank also purchases up to 90% participation interests in multi-family, commercial real estate and construction loans secured by real estate, most of which is located outside of the Bank s primary market area in southern Wisconsin and Minnesota. When determining whether to participate in such loans, the Bank will underwrite its participation interest according to its own underwriting standards. The Bank will generally hedge against participating in problematic loans by participating in those loans that have been in existence for at least one to two years and, accordingly, possess an established payment history. At December 31, 2004, the Bank had $25.0 million in multi-family real estate loan participation interests, or 45.2% of multi-family loans and 3.1% of total loans. In addition, the Bank had $43.9 million in commercial real estate loan participation interests as of the same date.

Loans secured by multi-family and commercial real estate properties generally involve larger principal amounts and a greater degree of risk than one- to four-family residential mortgage loans. Because payments on loans secured by multi-family and

commercial real estate properties are often dependent on successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks through its underwriting standards.

Construction and Land Lending. The Bank originates fixed-rate construction loans for the development of residential property primarily located in the Bank s market area. Construction loans are offered primarily to experienced local developers operating in the Bank s primary market area and, to a lesser extent, to individuals for the construction of their residence. The majority of the Bank s construction loans are originated or participation interests purchased primarily to finance the construction of one- to four-family, owner-occupied residential real estate and multi-family real estate properties located in the Bank s primary market area as well as southern Wisconsin and Minnesota. Construction loans are generally offered with terms up to 12 months and may be made in amounts up to 80% of the appraised value of the property, as improved. Construction loan proceeds are disbursed periodically in increments as construction progresses and as inspections by the Bank s lending personnel warrant.

The Bank also originates fixed-rate land loans to local developers for the purpose of developing the land for sale. Such loans are secured by a lien on the property, are limited to 75% of the appraised value of the secured property and have terms of up to three years. The principal of the loan is reduced as lots are sold and released. The Bank s land loans are generally secured by properties located in its primary market area. Generally, if the borrower is a corporation, partnership or other business entity, personal guarantees by the principals are required.

The Bank originated $59.5 million, $19.4 million and $31.0 million of construction and land loans for the years ended December 31, 2004, 2003 and 2002, respectively. At December 31, 2004, the Bank s largest construction or land loan was a performing loan with a $8.8 million balance secured by 36 acres of vacant land for development in Algonquin, Illinois. This loan was granted to a joint venture, of which the Bank s wholly-owned subsidiary, EFS Service Corporation, is involved. For more information see the Subsidiary Activities section of this report. At December 31, 2004, the Bank had $44.1 million of construction and land loans, which amounted to 5.4% of the Bank s total loans.

Construction and land financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-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 compared to the estimated cost (including interest) of construction and other assumptions, including the estimated time to sell residential properties. If the estimate of value proves to be inaccurate, the Bank may be confronted with a project, when completed, having a value that is insufficient to assure full repayment.

Commercial Business Lending. The Bank also originates commercial business loans in the forms of term loans and lines of credit to small- and medium-sized businesses operating in the Bank s primary market area. Equipment, leases, inventory, accounts receivable, and marketable securities generally secure such loans; however, the Bank also makes unsecured commercial business loans. The maximum amount of a commercial business loan is limited by the Bank s loans-to-one-borrower limit which, at December 31, 2004, was $20.9 million. Depending on the collateral used to secure the loans, commercial loans are made in amounts up to 80% of the value of the property securing the loan. Term loans are generally offered with fixed rates of interest and terms of up to 10 years. All term loans fully amortize during the term of such loan. Business lines of credit have adjustable rates of interest and terms of up to one year. Business lines of credit adjust on a daily basis and are indexed to the prime rate as published in *The Wall Street Journal*. The Bank also issues both secured and unsecured letters of credit to business customers of the Bank. Acceptable collateral includes an assigned deposit account with the Bank, real estate or marketable securities. Letters

of credit have a maximum term of 36 months.

In making commercial business loans, the Bank considers primarily the financial resources of the borrower, the borrower s ability to repay the loan out of net operating income, the Bank s lending history with the borrower and the value of the collateral. Generally, if the borrower is a corporation, partnership or other business entity, personal guarantees by the principals are required. However, personal guarantees may not be required on such loans depending on the creditworthiness of the borrower and other mitigating circumstances. The Bank continues to emphasize commercial business loans. The Bank s largest commercial loan at December 31, 2004 was $5.2 million. At such date, the Bank had $61.4 million of unadvanced commercial lines of credit. At December 31, 2004, the Bank had $39.4 million of commercial business loans, which amounted to 4.9% of the Bank s total loans. The Bank originated $50.0 million, $8.9 million and $9.1 million in commercial business loans for the years ended December 31, 2004, 2003 and 2002, respectively.

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

Consumer Lending. Consumer loans at December 31, 2004 amounted to $39.0 million, or 4.8% of the Bank s total loans, and consisted primarily of home equity lines of credit and, to a significantly lesser extent, secured and unsecured personal loans and new and used automobile loans. Such loans are generally originated in the Bank s primary market area and generally are secured by real estate, deposit accounts, personal property and automobiles.

Substantially all of the Bank s home equity lines of credit are secured by second mortgages on owner-occupied single-family residences located in the Bank s primary market area. At December 31, 2004, these loans totaled $31.7 million, or 3.9% of the Bank s total loans and 80.1% of consumer loans. Home equity lines of credit generally have adjustable-rates of interest, which adjust on a monthly basis. The unused home equity lines of credit totaled $34.5 million at December 31, 2004. The adjustable-rate of interest charged on such loans is indexed to the prime rate as reported in *The Wall Street Journal*. Home equity lines of credit generally have an 18% lifetime limit on interest rates. Generally, the maximum combined LTV ratio on home equity lines of credit is 89.9%. The underwriting standards employed by the Bank for home equity lines of credit include a determination of the applicant s credit history and an assessment of the applicant s ability to meet existing obligations and payments on the proposed loan and the value of the collateral securing the loan. The stability of the applicant s monthly income may be determined by verification of gross monthly income from primary employment and, additionally, from any verifiable secondary income. Creditworthiness of the applicant is of primary consideration.

The Bank also originates other types of consumer loans consisting of secured and unsecured personal loans and new and used automobile loans. Secured personal loans are generally secured by deposit accounts. Unsecured personal loans generally have a maximum borrowing limitation of $25,000 and generally require a debt ratio of 38%. Automobile loans have a maximum borrowing limitation of 80% of the sale price of the automobile, except that existing customers of the Bank who meet certain underwriting criteria may borrow up to 100% of the sale price of the automobile. At December 31, 2004, personal loans (both secured and unsecured) totaled $5.6 million or 0.7% of the Bank s total loans and 14.3% of consumer loans; and automobile loans totaled $1.7 million, or 0.2% of total loans and 4.4% of consumer loans.

With respect to automobile loans, full-time employees of the Bank, other than executive officers and directors, who satisfy certain lending criteria and the general underwriting standards of the Bank receive an interest rate 1% less than that which is offered to the general public; provided, however, that the discounted interest rate is at no time less than 75 basis points above the Bank s overall cost of funds, rounded to the highest quarter percentage point.

Loans secured by rapidly depreciable assets such as automobiles or that are unsecured entail greater risks than one- to four-family residential mortgage loans. In such cases, repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance, since there is a greater likelihood of damage, loss or depreciation of the underlying collateral. Further, consumer loan collections on these loans are dependent on the borrower s continuing financial stability and, therefore, are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Finally, 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 in the event of a default.

Loans-to-One Borrower Limitations. The Illinois Savings Bank Act imposes limitations on the aggregate amount of loans that an Illinois chartered savings bank can make to any one borrower. Under the Illinois Savings Bank Act the

permissible amount of loans-to-one borrower is the greater of $500,000 (for a savings bank meeting its minimum capital requirements) or 25% of a savings bank s total capital plus general loan loss reserves. In addition, a savings bank may make loans in an amount equal to an additional 10% of the savings bank s capital plus general loan loss reserves if the loans are 100% secured by readily marketable collateral. Under Illinois law, a savings bank s capital consists of capital stock and noncumulative perpetual preferred stock, related paid-in capital, retained earnings and other forms of capital deemed to be qualifying capital by the Federal Deposit Insurance Corporation (the FDIC). Illinois law also permits an institution with capital in excess of 6% of assets to request permission of the Illinois Commissioner of Banks and Real Estate (the Commissioner) to lend up to 30% of the institution s total capital and general loan loss reserves to one borrower for the development of residential housing properties within Illinois. At

December 31, 2004, the Bank s ordinary limit on loans-to-one borrower under the Illinois Savings Bank Act was $20.9 million. The 30% limitation equaled $25.1 million at that date. At December 31, 2004, the Bank s five largest groups of loans-to-one borrower ranged from $9.6 million to $14.9 million, with the largest single loan in such groups being a $6.2 million loan for the construction of town homes located in Elgin, Illinois. At December 31, 2004, there were no loans exceeding the 25% limitation. A substantial portion of each large group of loans is secured by real estate.

Loan Approval Procedures and Authority. The Board of Directors establishes the lending policies and loan approval limits of the Bank. The Board of Directors has established the Loan Committee (the Committee) of the Board, which considers and approves all loans within its designated authority as established by the Board. In addition, the Board of Directors has authorized certain officers of the Bank (the designated officers) to consider and approve all loans within their designated authority as established by the Board.

Underwriting. With respect to loans originated by the Bank, it is the general policy of the Bank to retain such loans in its portfolio. The Bank does not have a policy of underwriting its loans in conformance with the Fannie Mae or Federal Home Loan Mortgage Corporation (FHLMC) guidelines. Upon receipt of a completed loan application from a prospective borrower, a credit report is ordered and certain other information is verified by an independent credit agency. If necessary, additional financial information may be required. An appraisal of real estate intended to secure a proposed loan generally is required to be performed by the Bank s in-house appraisers or outside appraisers approved by the Bank. For proposed mortgage loans, the Board annually approves independent appraisers used by the Bank and approves the Bank s appraisal policy. The Bank s policy is to obtain title and hazard insurance on all mortgage loans and flood insurance when necessary and the Bank may require borrowers to make payments to a mortgage escrow account for the payment of property taxes.

At December 31, 2004, the Bank s ratio of nonperforming loans to total loans was 0.36%, and its ratio of nonperforming assets to total assets was 0.29%. The Bank did not have any real estate owned at December 31, 2004. Net charge-offs amounted to $18,000 in 2004. There were no net charge-offs in 2003 and net charge-offs in 2002 totaled $14,000. See Delinquent Loans, Classified Assets and Real Estate Owned.

The Bank s one- to four-family lending policy permits the investment in mortgage loans where the borrower s monthly mortgage and prorated real estate tax payments were less than 32% of the borrower s gross income, and where the borrower s total monthly obligations did not exceed 43% of the borrower s gross income. It is also the general practice of the Bank not to require private mortgage insurance, though the Bank retains the right to require such insurance on any loan with a loan to value ratio in excess of 80.0%. All loans with loan to value ratios in excess of 89.9% must have private mortgage insurance, with the exception of its First-Time Home Buyer and American Dream Loan programs. In addition, the Bank had historically priced its one- to four- family loans with loan to value ratios of between 80.0% and 89.9% at 25 basis points higher than loans with loan to value ratios of less than 80.0%, again in an effort to control the origination of such loans. The Bank believes that its underwriting standards are sufficient to allow it to adequately assess the creditworthiness of prospective borrowers. There can be no assurances, however, that increasing the permissible debt coverage ratios and loan-to-value ratios permitted for borrowers will not result in the Bank experiencing increased delinquencies and defaults on loans.

Delinquent Loans, Classified Assets and Real Estate Owned

Delinquencies, Classified Assets and Real Estate Owned. Reports listing all delinquent accounts are generated and reviewed by management on a monthly basis and the Board of Directors performs a monthly review of all loans or lending relationships delinquent 45 days or more. The procedures taken by the Bank with respect to delinquencies vary depending on the nature of the loan, period and cause of delinquency and whether the borrower is habitually delinquent. 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. The Bank generally sends the borrower a written notice of non-payment after the loan is first past due. The Bank s guidelines provide that telephone, written correspondence and/or face-to-face contact will be attempted to ascertain the reasons for delinquency and the prospects of repayment. When contact is made with the borrower at any time prior to foreclosure, the Bank will attempt to obtain full payment, offer to work out a repayment schedule with the borrower to avoid foreclosure or, in some instances, accept a deed in lieu of foreclosure. In the event payment is not then received or the loan not otherwise satisfied, additional letters and telephone calls generally are made. If the loan is still not brought current or satisfied and it becomes necessary for the Bank to take legal action, which typically occurs after a loan is 90 days or more delinquent, the Bank will commence foreclosure proceedings against any real property that secured the loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the property securing the loan generally is sold at

foreclosure and, if purchased by the Bank, becomes real estate owned.

Federal regulations and the Bank s internal policies require that the Bank utilize an internal asset classification system as a means of reporting problem and potential problem assets. The Bank currently classifies problem and potential problem assets 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 Bank 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. Assets which do not currently expose the Bank to a sufficient degree of risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated Special Mention. Loans classified Special Mention may have been delinquent in the past or had other weaknesses, however, in management s judgment risk of loss is not probable. This classification represents a watch list of loans for management to closely monitor.

When the Bank classifies one or more assets, or portions thereof, as Substandard or Doubtful, it establishes a specific allowance for probable loan losses in an amount deemed appropriate by management. When the Bank classifies one or more assets, or portions thereof, as Loss, it either establishes a specific allowance for losses equal to 100% of the amount of the assets so classified or charges off such amount.

The Bank s determination as to the classification of its assets and the amount of its allowances for loan losses is subject to review by the FDIC and Commissioner, which can order the establishment of additional general or specific loss allowances. The FDIC, in conjunction with the other federal banking agencies, adopted an interagency policy statement on the allowance for loan and lease losses. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that institutions have effective systems and controls to identify, monitor and address asset quality problems; that management has analyzed all significant factors that affect the collectibility of the portfolio in a reasonable manner; and that management has established acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. While the Bank believes that it has established an adequate allowance for loan losses, there can be no assurance that regulators, in reviewing the Bank s loan portfolio, will not request the Bank to increase at that time its allowance for loan losses, thereby negatively affecting the Bank s financial condition and earnings at that time. Although management believes that adequate specific and general loan loss allowances have been established, future provisions are dependent upon future events such as loan growth and portfolio diversification and, as such, further additions to the level of the allowance for loan losses may become necessary.

The Bank reviews and classifies its assets on a quarterly basis and the Board of Directors reviews the results of the reports on a quarterly basis. The Bank classifies its assets in accordance with the management guidelines described above. At December 31, 2004, the Bank had $2.9 million of assets, representing 0.36% of loans receivable, or 0.29%, of assets, designated as Substandard. No loans were classified as Doubtful, Loss, or Special Mention.

The following tables set forth delinquencies in the Bank s loan portfolio past due 60 days or more:

	At December 31, 2004								At December 31, 2003							
	60-89 Days				90 Days or More				60-89 Days				90 Days or More			
	Number of Loans		Principal Balance of Loans		Number of Loans		Principal Balance of Loans		Number of Loans		Principal Balance of Loans		Number of Loans		Principal Balance of Loans	
	(Dollars in thousands)															
One- to four-family	8	$	979		7	$	957		8	$	1,014		9	$	853	
Commercial real estate					1		500						1		505	
Consumer	2		5		3		23		5		18		3		14	
Home equity	1		20						5		166		2		77	
Commercial business	1		615		7		1,298		1		24		6		1,273	
Total	12	$	1,619		18	$	2,778		19	$	1,222		21	$	2,722	
Delinquent loans to total loans (1)			0.20%				0.34%				0.17%				0.38%	

	At December 31, 2002							
	60-89 Days				90 Days or More			
	Number of Loans		Principal Balance of Loans		Number of Loans		Principal Balance of Loans	
	(Dollars in thousands)							
One- to four-family	5	$	354		7	$	865	
Commercial real estate								
Consumer					3		47	
Home equity	1		11		2		126	
Commercial business					1		39	
Total	6	$	365		13	$	1,077	
Delinquent loans to total loans (1)			0.06%				0.18%	

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(1) Total loans represent gross loans receivable less deferred loan fees and unearned discounts.

Nonperforming Assets. The following table sets forth information regarding nonperforming loans and REO. It is the general policy of the Bank to cease accruing interest on loans 90 days or more past due and to fully reserve for all previously accrued interest. For each of the five years ended December 31, 2004, the amount of additional interest income that would have been recognized on non-accrual loans if such loans had continued to perform in accordance with their contractual terms was $99,000 $82,000, $198,000, $187,000, and $89,000, respectively.

	At December 31,				
	2004	2003	2002	2001	2000
	(Dollars in thousands)				
Nonperforming loans:					
Mortgage loans:					
One- to four-family	$ 1,091	$ 853	$ 865	$ 547	$ 864
Multi-family					
Commercial real estate	500	505		1,623	3,505
Total mortgage loans	1,591	1,358	865	2,170	4,369
Other loans:					
Home equity	20	89	126		
Commercial business loans	1,298	1,297	1,358	402	148
Auto loans	7	22	8	8	15
Other	16	1	39		
Total other loans	1,341	1,409	1,531	410	163
Total nonperforming loans	2,932	2,767	2,396	2,580	4,532
Real estate owned			1,986		540
Total nonperforming assets	$ 2,932	$ 2,767	$ 4,382	$ 2,580	$ 5,072
Nonperforming loans as a percent of loans (1)	0.36%	0.38%	0.40%	0.48%	0.98%
Nonperforming assets as a percent of total assets (2)	0.29%	0.31%	0.56%	0.38%	0.87%

(1) Loans receivable, gross.

(2) Nonperforming assets consist of nonperforming loans and REO.

Nonperforming loans totaled $2.9 million as of December 31, 2004, and included eight one- to four-family loans, with an aggregate balance of $1.1 million, one commercial real estate loan totaling $500,000, seven commercial business loans totaling $1.3 million, two automobile loans totaling $7,000, one consumer loan totaling $16,000 and one home equity line of credit totaling $20,000.

Allowance for Loan Losses Critical Accounting Policy

The allowance for loan losses is considered by management to be a critical accounting policy. The allowance for loan losses is maintained through provisions for loan losses based on management s on-going evaluation of the risks inherent in its loan portfolio in consideration of the trends in its loan portfolio, the national and regional economies and the real estate market in the Bank s primary lending area. The allowance for loan losses is maintained at an amount management considers adequate to cover probable losses in its loan portfolio, based on information currently known to management. The Bank s loan loss allowance determinations also incorporate factors and analyses which consider the probable principal loss associated with the loan, costs of acquiring the property securing the loan through foreclosure or deed in lieu of foreclosure. While management estimates loan losses using the best available information, no assurance can be given that future additions to the allowance will not be necessary based on changes in economic and real estate market conditions, further information obtained regarding problem loans, identification of additional problem loans and other factors, both within and outside of management s control.

Management calculates a loan loss allowance sufficiency analysis quarterly based upon the loan portfolio composition, asset classifications, loan-to-value ratios, impairments in the loan portfolio and other factors. The analysis is compared to actual losses, peer group comparisons and economic conditions. As of December 31, 2004, the Bank s allowance for loan losses was $4.5 million, or 0.56%, of total loans and 153.4% of nonperforming loans as compared to $3.8 million, or 0.52%, of total loans and 135.7% of nonperforming loans as of December 31, 2003. The Bank had total nonperforming loans of $2.9 million at December 31, 2004 as compared to $2.8 million at December 31, 2003 and

nonperforming loans to total loans of 0.36% and 0.39% at December 31, 2004 and 2003, respectively. The Bank will continue to monitor and modify its allowance for loan losses as conditions dictate. Management believes that, based on information available at December 31, 2004, the Bank s allowance for loan losses was adequate to cover probable losses inherent in its loan portfolio at that time. Based upon the Bank s plan to increase its emphasis on non-one- to four-family mortgage lending which consist of secured commercial loans which are generally considered to involve a higher degree of risk than one- to four-family mortgage lending, the Bank has and may continue to further

increase its allowance for loan losses over future periods depending upon the then current conditions. The percentage of one- to four-family loans to total loans decreased to 62.0% at December 31, 2004 from 64.8% at December 31, 2003. At the same time, the percentage of commercial real estate loans to total loans increased to 16.1% at December 31, 2004 from 15.2% at December 31, 2003. However, no assurances can be given that the Bank s level of allowance for loan losses will be sufficient to cover loan losses incurred by the Bank or that future adjustments to the allowance for loan losses will not be necessary if economic and other conditions differ substantially from the economic and other conditions used by management to determine the current level of the allowance for loan losses. In addition, the FDIC and the Commissioner, as an integral part of their examination processes, periodically review the Bank s allowance for loan losses. Such agencies may require the Bank to make additional provisions for estimated loan losses based upon judgments different from those of management.

The following table sets forth activity in the Bank s allowance for loan losses for the periods set forth in the table.

	At or For the Year Ended December 31,				
	2004	2003	2002	2001	2000
	(Dollars in thousands)				
Balance at beginning of year	$ 3,754	$ 3,141	$ 2,255	$ 1,881	$ 1,545
Provision for loan losses	760	613	900	500	363
Charge-offs	(19)		(16)	(126)	(28)
Recoveries	1		2		1
Balance at end of year	$ 4,496	$ 3,754	$ 3,141	$ 2,255	$ 1,881
Allowance for loan losses as a percent of loans (1)	0.56%	0.52%	0.52%	0.42%	0.41%
Allowance for loan losses as a percent of nonperforming loans	153.4%	135.7%	131.1%	87.4%	41.5%

(1) Loans receivable, gross.

The following tables set forth the Bank s percent of allowance for loan losses to total allowance and the percent of loans to total loans in each of the categories listed at the dates indicated.

	At December 31,												
	2004			2003			2002			2001			
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Each Category to Total Loans	Amo
	(Dollars in thousands)												
One- to four-family	$ 1,041	23.2%	62.0%	$ 987	26.3%	64.8%	$ 838	26.7%	67.6%	$ 765	33.9%	69.6%	$
Multi-family	166	3.7	6.8	157	4.2	7.3	118	3.7	7.1	158	7.0	10.8	
Commercial real estate	1,244	27.7	16.1	1,094	29.1	15.2	678	21.6	8.7	352	15.6	7.9	
Construction and land	424	9.4	5.4	363	9.7	5.0	422	13.4	6.9	131	5.8	3.0	
Home equity	96	2.1	3.9	283	7.5	3.8	223	7.1	3.5	147	6.5	2.7	
Commercial business loans	1,288	28.6	4.9	698	18.6	3.1	666	21.2	5.6	575	25.5	5.6	
Auto loans	35	0.8	0.2	33	0.9	0.2	24	0.8	0.2	17	0.8	0.1	
Loans on savings accounts									0.1			0.1	
Other	59	1.3	0.7	44	1.2	0.6	26	0.8	0.3	24	1.1	0.2	
Unallocated	143	3.2		95	2.5		146	4.7		86	3.8		
Total allowance for loan losses	$ 4,496	100.0%	100.0%	$ 3,754	100.0%	100.0%	$ 3,141	100.0%	100.0%	$ 2,255	100.0%	100.0%	$ 1,

Real Estate Owned. At December 31, 2004, the Bank did not have any real estate owned (REO). When the Bank acquires property through foreclosure or deed in lieu of foreclosure, it is initially recorded at the lower of the recorded investment in the corresponding loan or the fair value of the related assets at the date of foreclosure, less costs to sell. Thereafter, if there is a further deterioration in value, the Bank provides for a specific valuation allowance and charges operations for the diminution in value.

Real Estate Held For Development. On June 19, 2002, EFS Service Corporation, a wholly-owned subsidiary of the Bank, acquired approximately 16 acres of vacant land located in West Dundee, Illinois. This land was developed into 29 home-sites for single-family residences. On October 15, 2004, one of the model homes previously built was sold. On November 15, 2004, 25 developed lots were sold to a local homebuilder. As of December 31, 2004, this investment totaled $1.5 million and there were three homes in various stages of completion, one of which was under contract for sale.

Investment Activities

The Board of Directors sets the investment policy and procedures of the Bank. This policy generally provides that investment decisions will be made based on the safety of the investment, liquidity requirements of the Bank and, to a lesser extent, potential return on the investments. In pursuing these objectives, the Bank considers the ability of an investment to provide earnings consistent with factors of quality, maturity, marketability and risk diversification. While the Board of Directors has final authority and responsibility for the securities investment portfolio, the Bank has established an Investment Committee comprised of five Directors to supervise the Bank s investment activities. The Bank s Investment Committee meets at least quarterly and evaluates all investment activities for safety and soundness, adherence to the Bank s investment policy, and assurance that authority levels are maintained.

The Bank currently does not participate in hedging programs, interest rate swaps, or other activities involving the use of derivative financial instruments. Similarly, the Bank does not invest in mortgage-related securities which are deemed to be high risk, or purchase bonds which are not rated investment grade.

Mortgage-Backed Securities. The Bank currently purchases mortgage-backed securities in order to: (i) generate positive interest rate spreads with minimal administrative expense; and (ii) lower its credit risk as a result of the guarantees provided by FHLMC, FNMA, and the Government National Mortgage Association (GNMA). The Bank invests in mortgage-backed securities insured or guaranteed by FNMA, FHLMC and GNMA. At December 31, 2004, mortgage-backed securities totaled $10.0 million, or 1.0%, of both total and interest earning assets, all of which were classified as available-for-sale. At December 31, 2004, 7.9% of the mortgage-backed securities were backed by adjustable-rate loans and 92.1% were backed by fixed-rate loans. The mortgage-backed securities portfolio had coupon rates ranging from 3.0% to 10.0% and had a weighted average yield of 4.06% at December 31, 2004.

Mortgage-backed securities are created by the pooling of mortgages and issuance of a security with an interest rate that is less than the interest rate on the underlying mortgages. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although the Bank focuses its investments on mortgage-backed securities backed by single-family mortgages. The issuers of such securities (generally U.S. Government agencies and government sponsored enterprises, including FNMA, FHLMC and GNMA) pool and resell the participation interests in the form of securities to investors such as the Bank and guarantee the payment of principal and interest to investors. Mortgage-backed securities generally yield less than the loans that underlie such securities because of the cost of payment guarantees and credit enhancements. In addition, mortgage-backed securities are usually more liquid than individual mortgage loans and may be used to collateralize certain liabilities and obligations of the Bank. Investments in mortgage-backed securities involve a risk that actual prepayments will be greater than estimated prepayments over the life of the security, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments thereby reducing the net yield on such securities. There is also reinvestment risk associated with the cash flows from such securities or in the event the issuer redeems such securities. In addition, the market value of such securities may be adversely affected by changes in interest rates. The Bank estimates prepayments for its mortgage-backed securities at purchase to ensure that prepayment assumptions are reasonable considering the underlying collateral for the mortgage-backed securities at issue and current mortgage interest rates and to determine the yield and estimated maturity of its mortgage-backed security portfolio. Of the Bank s $10.0 million mortgage-backed securities portfolio at December 31, 2004, $25,000 with a weighted average yield of 9.53% had contractual maturities within five years and $10.0 million with a weighted average yield of 4.05% had contractual maturities over five years. However, the actual maturity of a mortgage-backed security may be less than its stated maturity due to prepayments of the underlying mortgages. Prepayments that are faster than anticipated may shorten the life of the security and may result in a loss of any premiums paid and thereby reduce the net yield on such securities. Although prepayments of underlying mortgages depend on many factors, the difference between the interest rates on the underlying mortgages and the prevailing mortgage interest rates generally is the most significant determinant of the rate of prepayments. During periods of declining mortgage interest rates, refinancing generally increases and accelerates the prepayment of the underlying mortgages and the related security. Under such circumstances, the Bank may be subject to reinvestment risk because, to the

extent that the Bank s mortgage-backed securities prepay faster than anticipated, the Bank may not be able to reinvest the proceeds of such repayments and prepayments at a comparable rate.

U.S. Government Obligations. At December 31, 2004, the Bank s U.S. Government securities portfolio totaled $39.0 million, all of which were classified as available-for-sale. Such portfolio primarily consists of medium-term (maturities of three to fifteen years) securities.

Municipal Securities. At December 31, 2004, the Bank s municipal security portfolio totaled $37.5 million and was classified as available-for-sale. This portfolio consists of general obligations issued by municipalities.

Equity Investments. At December 31, 2004, the Bank s equity investment portfolio totaled $15.0 million, all of which were classified as available-for-sale. The portfolio consists of $100,000 of common stock and $200,000 of preferred stock in a small privately held company specializing in interest rate risk management and web site design consulting and $9.8 million and $5.0 million of FNMA and FHLMC preferred stock, respectively.

Corporate Bonds. At December 31, 2004, the Bank s corporate bond portfolio totaled $1.3 million, all of which were classified as available-for-sale. This portfolio consists of highly rated corporate debt issuances.

The following table sets forth the composition of the carrying value of the Bank s available-for-sale investment and mortgage-backed securities portfolios in dollar amounts and in percentages at the dates indicated:

	At December 31,					
	2004		2003		2002	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
			(Dollars in thousands)			
Investment securities:						
U.S. Government obligations						
Equity investments	$ 39,018	37.9%	$ 36,064	35.8%	$ 32,842	31.8%
Municipal securities	15,047	14.6	15,512	15.4	10,521	10.2
Corporate bonds	37,483	36.5	33,650	33.4	35,608	34.5
Total investment securities	1,299	1.3	5,430	5.4	9,011	8.7
	92,847	90.3	90,656	89.9	87,982	85.2
Mortgage-backed securities:						
FHLMC	1,473	1.4	3,044	3.0	6,734	6.5
GNMA	7,288	7.1	5,013	5.0	4,687	4.6
FNMA	1,216	1.2	2,108	2.1	3,835	3.7
Total mortgage-backed securities	9,977	9.7	10,165	10.1	15,256	14.8
Total securities	$ 102,824	100.0%	$ 100,821	100.0%	$ 103,238	100.0%

The following table sets forth the Bank s securities activities for the periods indicated. All investment securities in the Bank s portfolio are classified as available-for-sale. In the fourth quarter 2004, a $1.1 million other-than temporary impairment charge was recorded by the Company relating to it s investment in FNMA preferred stock.

		For the Year Ended December 31, (In thousands)	
	2004	2003	2002
Beginning balance	$ 100,821	$ 103,238	$ 82,471
Investment securities purchased	39,378	48,075	45,058
Mortgage-backed securities purchased	4,036	2,549	7,170
Less:			
Sale of investment securities	9,961	15,350	
Principal repayments on mortgage-backed securities	4,095	7,363	5,593
Maturities of investment securities	26,502	29,700	27,548
Impairment on securities	1,140		
Gain on sale of investment securities	(511)	(816)	
Net amortization of premium	(84)	(101)	(9)
Change in net unrealized gains (losses) on available-for-sale securities	140	1,343	(1,689)
Ending balance	$ 102,824	$ 100,821	$ 103,238

The following table sets forth at the dates indicated certain information regarding the amortized cost and market values of the Bank s investment and mortgage-backed securities, all of which were classified as available-for-sale.

			At December 31, (In thousands)			
	2004		2003		2002	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Investment securities:						
U.S. Government obligations	$ 39,546	$ 39,018	$ 36,081	$ 36,064	$ 32,111	$ 32,842
Equity investments	15,095	15,047	16,238	15,512	10,247	10,521
Municipal securities	36,359	37,483	32,558	33,650	34,765	35,608
Corporate bonds	1,214	1,299	5,039	5,430	8,871	9,011
Total investment securities	92,214	92,847	89,916	90,656	85,994	87,982
Mortgage-backed securities:						
GNMA	7,345	7,288	5,058	5,013	4,661	4,687
FNMA	1,201	1,216	2,081	2,108	3,796	3,835
FHLMC	1,478	1,473	3,040	3,044	6,718	6,734
Total mortgage-backed securities	10,024	9,977	10,179	10,165	15,175	15,256
Total securities	$ 102,238	$ 102,824	$ 100,095	$ 100,821	$ 101,169	$ 103,238

The table below sets forth certain information regarding the carrying value, weighted average yields and contractual maturities of the Bank s securities portfolio, excluding equity securities, all of which were classified as available-for-sale, as of December 31, 2004. The yields on tax-exempt securities have not been calculated on a tax equivalent basis.

	At December 31, 2004									
	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
	(Dollars in thousands)									
Mortgage-backed securities:										
FHLMC	$	%	$	%	$ 127	7.65%	$ 1,347	4.40%	$ 1,474	4.68%
GNMA			25	9.53	137	9.02	7,125	3.47	7,287	3.60
FNMA							1,216	6.10	1,216	6.10
Total mortgage-backed securities			25	9.53	264	8.36	9,688	3.93	9,977	4.06
Municipal securities	265	3.40	832	4.04	10,078	4.19	26,308	5.47	37,483	5.08
Corporate bonds			1,299	8.20					1,299	8.20
U.S. Government Obligations			2,997	3.55	26,184	4.63	9,837	4.11	39,018	4.42
Total securities	$ 265	3.40	$ 5,128	4.81	$ 36,262	4.51	$ 36,145	5.10	$ 77,800	4.80

Sources of Funds

General. Deposits, repayments and prepayments of loans, cash flows generated from operations and FHLB advances are the primary sources of the Bank s funds for use in lending, investing and for other general purposes.

Deposits. The Bank offers a variety of deposit accounts with a range of interest rates and terms. The Bank s deposit accounts consist of savings, retail checking/NOW accounts, commercial checking accounts, money market accounts, club accounts and certificate of deposit accounts. The Bank offers certificate of deposit accounts with balances in excess of $100,000 at preferential rates (jumbo certificates) and also offers Individual Retirement Accounts (IRAs) and other qualified plan accounts.

At December 31, 2004, the Bank s deposits totaled $671.0 million, or 73.9%, of interest-bearing liabilities. For the year ended December 31, 2004, the average balance of core deposits (savings, NOW, money market and non-interest-bearing checking accounts) totaled $322.1 million, or 52.1% of total average deposits. At December 31, 2004, the Bank had a total of $322.8 million in certificates of deposit, of which $112.6 million had maturities of one year or less reflecting the shift in deposit accounts from savings accounts to shorter-term certificate accounts that has occurred in recent years. For the year ended December 31, 2004, the average balance of core deposits represented approximately 48.0% of total deposits and average certificate accounts represented 44.2%, as compared to the average balance of core deposits representing 57.0% of total deposits and average certificate accounts representing 38.0% of deposits for the year ended December 31, 2003. Although the Bank has a significant portion of its deposits in core deposits, management monitors activity on the Bank s core deposits and, based on historical experience and the Bank s current pricing strategy, believes it will continue to retain a large portion of such accounts. The Bank is not limited with respect to the rates it may offer on deposit products.

At December 31, 2004 and 2003, the Bank had brokered deposits totaling $16.0 million.

The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. The Bank s deposits are obtained predominantly from the areas in which its branch offices are located. The Bank relies primarily on customer service and long-standing relationships with customers to attract and retain these deposits; however, market interest rates and rates offered by competing financial institutions affect the Bank s ability to attract and retain deposits. The Bank uses traditional means of advertising its deposit products, including radio and print media and generally does not solicit deposits from outside its market area. While certificate accounts in excess of $100,000 are accepted by the Bank, and may be subject to preferential rates, the Bank does not actively solicit such deposits as such deposits are more difficult to retain than core deposits.

At December 31, 2004, the Bank had outstanding $156.9 million in certificate of deposit accounts in amounts of $100,000 or more, maturing as follows:

Maturity Period		Amount	Weighted Average Rate
		(Dollars in thousands)	
Three months or less	$	33,664	2.42%
Over three through six months		6,405	2.49
Over six through 12 months		18,533	2.92
Over 12 months		98,330	3.17
Total	$	156,932	2.95

The following table sets forth the distribution of the Bank s deposit accounts for the periods indicated and the weighted average interest rates on each category of deposits presented.

	At December 31, 2004				At December 31, 2003			
		Balance	Percent of Total Deposits	Weighted Average Rate		Balance	Percent of Total Deposits	Weighted Average Rate
	(Dollars in thousands)							
Money market accounts	$	118,040	17.59%	1.62%	$	145,530	24.39%	1.84%
Passbook savings accounts		141,207	21.04	1.42		127,929	21.44	1.56
NOW accounts		42,448	6.33	0.50		39,122	6.55	0.72
Non interest-bearing accounts		46,589	6.94			39,037	6.54	
Total		348,284	51.90	1.19		351,618	58.92	1.41
Certificates of deposit		322,752	48.10	2.94		245,146	41.08	3.10
Total deposits	$	671,036	100.00%	2.07	$	596,764	100.00%	2.16

	At December 31, 2002			
		Balance	Percent of Total Deposits	Weighted Average Rate
	(Dollars in thousands)			
Money market accounts	$	140,857	26.87%	2.73%
Passbook savings accounts		106,599	20.34	2.28
NOW accounts		34,201	6.52	1.01
Non interest-bearing accounts		32,655	6.23	
Total		314,312	59.96	2.11
Certificates of deposit		209,878	40.04	3.63
Total deposits	$	524,190	100.00%	2.72

The following table presents, by various rate categories, the amount of certificate of deposit accounts outstanding at the dates indicated.

Investment Activities

Period to Maturity
from December 31, 2004