GUARANTY FEDERAL BANCSHARES INC
Form 10-K
March 31, 2008

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

FORM 10-K

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

For the fiscal year ended December 31, 2007

- or -

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

For the transition period from ____________________ to ____________________

Commission File Number: 0-23325

GUARANTY FEDERAL BANCSHARES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	43-1792717 (I.R.S. Employer Identification No.)
1341 West Battlefield, Springfield, Missouri (Address of Principal Executive Offices)	65807 (Zip Code)

Registrant's telephone number, including area code: (417) 520-4333

Securities registered pursuant to Section 12(b) of the Act: Common Stock, par value $.10 per share
(Title of Class)
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 o   No x

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

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

Large accelerated file 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 and non-voting common stock held by non-affiliates of the registrant, based on the average bid and asked prices of the registrant's Common Stock as quoted on the Global Market of The NASDAQ Stock Market on June 30, 2007 (the last business day of the registrant’s most recently completed second quarter) was $70.3 million. As of March 18, 2008 there were 2,706,675 shares of the registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Stockholders (the “2007 Annual Report”) for the fiscal year ended December 31, 2007 (Parts I and II).
2. Portions of the Proxy Statement for the Annual Meeting of Stockholders (the “Proxy Statement”) to be held on May 28, 2008 (Part III).

GUARANTY FEDERAL BANCSHARES, INC.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

GUARANTY FEDERAL BANCSHARES, INC. (THE "COMPANY") MAY FROM TIME TO TIME MAKE WRITTEN OR ORAL "FORWARD-LOOKING STATEMENTS", INCLUDING STATEMENTS CONTAINED IN THE COMPANY'S FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION (INCLUDING THIS ANNUAL REPORT ON FORM 10-K AND THE EXHIBITS THERETO), IN ITS REPORTS TO STOCKHOLDERS AND IN OTHER COMMUNICATIONS BY THE COMPANY, WHICH ARE MADE IN GOOD FAITH BY THE COMPANY PURSUANT TO THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. WHEN USED IN THIS ANNUAL REPORT ON FORM 10-K, WORDS SUCH AS “ANTICIPATES,” “ESTIMATES,” “BELIEVES,” “EXPECTS,” AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY SUCH FORWARD-LOOKING STATEMENTS BUT ARE NOT THE EXCLUSIVE MEANS OF IDENTIFYING SUCH STATEMENTS.

THESE FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES, SUCH AS STATEMENTS OF THE COMPANY'S PLANS, OBJECTIVES, EXPECTATIONS, ESTIMATES AND INTENTIONS, THAT ARE SUBJECT TO CHANGE BASED ON VARIOUS IMPORTANT FACTORS (SOME OF WHICH ARE BEYOND THE COMPANY'S CONTROL). THE FOLLOWING FACTORS, AMONG OTHERS, COULD CAUSE THE COMPANY'S FINANCIAL PERFORMANCE TO DIFFER MATERIALLY FROM THE PLANS, OBJECTIVES, EXPECTATIONS, ESTIMATES AND INTENTIONS EXPRESSED IN SUCH FORWARD-LOOKING STATEMENTS: THE STRENGTH OF THE UNITED STATES ECONOMY IN GENERAL AND THE STRENGTH OF THE LOCAL ECONOMIES IN WHICH THE COMPANY CONDUCTS OPERATIONS; THE EFFECTS OF, AND CHANGES IN, TRADE, MONETARY AND FISCAL POLICIES AND LAWS, INCLUDING INTEREST RATE POLICIES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, INFLATION, INTEREST 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 WILLINGNESS OF USERS TO SUBSTITUTE COMPETITORS' PRODUCTS AND SERVICES FOR THE COMPANY'S PRODUCTS AND SERVICES; THE SUCCESS OF THE COMPANY IN GAINING REGULATORY APPROVAL OF ITS PRODUCTS AND SERVICES, WHEN REQUIRED; THE IMPACT OF CHANGES IN FINANCIAL SERVICES' LAWS AND REGULATIONS (INCLUDING LAWS CONCERNING TAXES, BANKING, SECURITIES AND INSURANCE); TECHNOLOGICAL CHANGES; ACQUISITIONS; CHANGES IN CONSUMER SPENDING AND SAVING HABITS; THE SUCCESS OF THE COMPANY AT MANAGING THE RISKS RESULTING FROM THESE FACTORS; AND OTHER FACTORS SET FORTH IN REPORTS AND OTHER DOCUMENTS FILED BY THE COMPANY WITH THE SECURITIES AND EXCHANGE COMMISSION FROM TIME TO TIME. FOR FURTHER INFORMATION ABOUT THESE AND OTHER RISKS, UNCERTAINTIES AND FACTORS, PLEASE REVIEW THE DISCLOSURE INCLUDED IN ITEM 1A. OF THIS FORM 10-K.

THE COMPANY CAUTIONS THAT THE LISTED FACTORS ARE 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.

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PART I

Item 1. Business

Business of the Company

Guaranty Federal Bancshares, Inc. (the “Company”) is a Delaware-chartered corporation that was created in September 1997 at the direction of Guaranty Federal Savings Bank, a federal savings bank (the "Bank"). The Company became a unitary savings and loan holding company for the Bank on December 30, 1997, in connection with a plan of conversion and reorganization involving the Bank and its then existing mutual holding company. The mutual holding company structure had been created in April 1995 at which time more than a majority of the shares of the Bank were issued to the mutual holding company and the remaining shares were sold in a public offering. In connection with the conversion and reorganization on December 30, 1997, the shares of the Bank held by the mutual holding company were extinguished along with the mutual holding company, and the shares of the Bank held by the public were exchanged for shares of the Company. All of the shares of the Bank which remained outstanding after the conversion are owned by the Company. Shares of the Company were issued on December 30, 1997.

On June 27, 2003, the Bank converted from a federal savings bank to a state-chartered trust company with banking powers in Missouri, and the Company became a bank holding company. On this date, the name of the Bank was changed from Guaranty Federal Savings Bank to Guaranty Bank. The primary activity of the Company is to oversee its investment in the Bank. The Company engages in few other activities. For this reason, unless otherwise specified, references to the Company include operations of the Bank. Further, information in a chart or table based on Bank only data is identical to or immaterially different from information that would be provided on a consolidated basis. In addition to the Bank, the Company owns Guaranty Statutory Trust I and Guaranty Statutory Trust II, both Delaware statutory trusts.

In 2003, the Company changed its fiscal year end from June 30 to a calendar year end of December 31. As a result, the Company reported a six month transition period ended December 31, 2003 (the “Transition Period”) in order to change to this new calendar year end.

Business of the Bank

The Bank's principal business has been, and continues to be, attracting retail deposits from the general public and investing those deposits, together with funds generated from operations, in permanent one-to four-family residential mortgage loans, multi-family residential mortgage loans, construction loans, commercial real estate loans, and consumer and other loans. The Bank also invests in mortgage-backed securities, U.S. Government and federal agency securities and other marketable securities. The Bank's revenues are derived principally from interest on its loans and other investments and fees charged for services provided, and gains generated from sales of loans and investment securities, and the Bank’s results of operations are primarily dependent on net interest margin, which is the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. The Bank's primary sources of funds are: deposits; borrowings; amortization and prepayments of loan principal; and amortizations, prepayments and maturities of investment securities.

The Bank is regulated by the Missouri Division of Finance and its deposits are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the "FDIC"). See discussion under section captioned “Regulation” in this report. The Bank is a member of the Federal Home Loan Bank of Des Moines (the “FHLB”), which is one of twelve regional Federal Home Loan Banks. As a member, the Bank is required to purchase and maintain stock in the FHLB in an amount equal to 0.12% of its assets plus 4.45% of its outstanding FHLB advances. At December 31, 2007, the Bank had $4,014,700 in FHLB stock, which was in compliance with this requirement.

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Information regarding (i) average balances related to interest earning assets and interest bearing liabilities and an analysis of net interest earnings for the last three fiscal years and (ii) changes in interest income and interest expense resulting from changes in average balances and average rates for the last two fiscal years is provided under the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operation – Average Balances, Interest and Averages Yields" of the 2007 Annual Report is incorporated herein by reference.

Market Area

The Bank's primary market areas are Greene and Christian Counties, which are in the southwestern corner of Missouri and includes the cities of Springfield and Nixa, Missouri. There is a large regional health care presence with two large regional hospitals. There also are four accredited colleges and one major university. Part of the area's growth can be attributed to its proximity to Branson, Missouri, which has developed a strong tourism industry related to country music and entertainment. Branson is located 30 miles south of Springfield, and attracts between five and six million tourists each year, many of whom pass through Springfield.

Lending Activities

Set forth below is selected data relating to the composition of the Bank's loan portfolio at the dates indicated:

	As of December 31,									
	2007		2006		2005		2004		2003	
	$	%	$	%	$	%	$	%	$	%
	Dollars in Thousands									
Mortgage loans (includes loans held for sale):										
One to four family	$ 85,160	16%	$ 89,650	18%	103,532	23%	121,307	31%	$ 129,477	37%
Multi-family	41,948	8%	50,366	10%	53,631	12%	52,259	13%	44,242	13%
Construction	89,724	17%	83,967	17%	70,390	16%	45,090	11%	49,814	14%
Commercial real estate	175,995	34%	155,801	32%	122,884	28%	97,550	25%	72,105	21%
Total mortgage loans	392,827	75%	379,784	78%	350,437	79%	316,206	80%	295,638	86%
Commercial business loans	104,026	20%	82,676	17%	66,370	15%	55,606	14%	24,618	7%
Consumer loans	25,576	5%	23,708	5%	24,264	6%	25,172	6%	25,441	7%
Total consumer and other loans	129,602	25%	106,384	22%	90,634	21%	80,778	20%	50,059	14%
Total loans	522,429	100%	486,168	100%	441,071	100%	396,984	100%	345,697	100%
Less:										
Loans in process	-		-		-		-		9,425	
Deferred loan fees/costs, net	224		115		141		106		237	
Unearned discounts	-		-		3		7		19	
	5,963		5,784		5,400		4,537		3,886	

Allowance for loan losses					
Total Loans, net	$ 516,242	$ 480,269	435,527	392,334	$ 332,130

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The following table sets forth the maturity of the Bank's loan portfolio as of December 31, 2007. The table shows loans that have adjustable rates as due in the period during which they contractually mature. The table does not include prepayments or scheduled principal amortization.

Loan Maturities		Due in One Year or Less	Due After One Through Five Years	Due After Five Years		Total
		(Dollars in thousands)				
One to four family	$	13,353	17,922	53,884		85,160
Multi family		14,460	8,434	19,054		41,948
Construction		77,556	12,169	-		89,724
Commercial real estate		83,383	91,239	1,372		175,995
Commercial loans		57,262	38,222	8,541		104,026
Consumer loans		3,309	6,468	15,800		25,576
Total loans (1)	$	249,323	174,455	98,651		522,429
Less:						
Deferred loan fees/costs						224
Allowance for loan losses						5,963
Loans receivable net					$	516,242

(1) Includes mortgage loans held for sale of $2,142

The following table sets forth the dollar amount, before deductions for unearned discounts, deferred loan fees/costs and allowance for loan losses, as of December 31, 2007 of all loans due after December 2008, which have pre-determined interest rates and which have adjustable interest rates.

Fixed and Adjustable Rate Loans by Type

		Fixed Rates	Adjustable Rates	Total	% ARM
		(Dollars in Thousands)			
One-to four-family	$	20,411	51,396	71,807	72%
Multi-family		17,891	9,597	27,488	35%
Construction		1,307	10,862	12,169	89%
Commercial real estate		28,586	64,025	92,611	69%
Commercial loans		10,786	35,977	46,763	77%
Consumer loans		5,483	16,785	22,268	75%
Total loans (1)	$	84,464	188,642	273,106	69%

(1) Before deductions for unearned discounts, deferred loan fees/costs and allowances for loan losses.

One- to Four-Family Mortgage Loans. The Bank offers fixed- and adjustable-rate ("ARM") first mortgage loans secured by one- to four-family residences in the Bank's primary lending area. Typically, such residences are single family homes that serve as the primary residence of the owner. However, there are a significant number of loans originated by the Bank which are secured by non-owner occupied properties. Loan originations are generally obtained from existing or past customers, members of the local community, attorney referrals, established builders, and realtors within the Bank's market area. Originated mortgage loans in the Bank's portfolio include due-on-sale clauses which provide the Bank with the contractual right to deem the loan immediately due and payable in the event that the borrower transfers ownership of the property without the Bank's consent.

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As of December 31, 2007, $85.2 million or 16% of the Bank's total loan portfolio consisted of one- to four-family residential loans, of which 72% were ARM loans. The Bank currently offers ARM and balloon loans that have fixed interest rate periods of one to seven years. Generally, ARM loans provide for limits on the maximum interest rate adjustment ("caps") that can be made at the end of each applicable period and throughout the duration of the loan. ARM loans are originated for a term of up to 30 years on owner-occupied properties and generally up to 25 years on non-owner occupied properties. Typically, interest rate adjustments are calculated based on U.S. treasury securities adjusted to a constant maturity of one year (CMT), plus a 2.50% to 2.75% margin. Interest rates charged on fixed-rate loans are competitively priced based on market conditions and the cost of funds existing at the time the loan is committed. The Bank's fixed-rate mortgage loans are made for terms of 15 to 30 years which are currently being sold on the secondary market.

Generally, ARM loans pose credit risks different from the risks inherent in fixed-rate loans, primarily because as interest rates rise the underlying payments of the borrower rise, thereby increasing the potential for default. At the same time, the marketability of the underlying property may be adversely affected by higher interest rates. The Bank does not originate ARM loans that provide for negative amortization.

The Bank generally originates both owner occupied and non-owner occupied one- to four-family residential mortgage loans in amounts up to 80% of the appraised value or the selling price of the mortgaged property, whichever is lower. The Bank on occasion may make loans up to 95% of appraised value or the selling price of the mortgage property, whichever is lower. However, the Bank typically requires private mortgage insurance for the excess amount over 80% for mortgage loans with loan to value percentages greater than 80%.

Multi-Family Mortgage Loans. The Bank originates multi-family mortgage loans in its primary lending area. As of December 31, 2007, $41.9 million or 8% of the Bank's total loan portfolio consisted of multi-family residential real estate loans. With regard to multi-family mortgage loans, the Bank generally requires personal guarantees of the principals as well as a security interest in the real estate. Multi-family mortgage loans are generally originated in amounts of up to 80% of the appraised value of the property. A portion of the Bank's multi-family mortgage loans have been originated with adjustable rates of interest which are quoted at a spread to the FHLB advance rate for the initial fixed rate period with subsequent adjustments based on the Wall Street prime rate. The loan-to-one-borrower limitation, $15.5 million as of December 31, 2007, is the maximum the Bank will lend on a multi-family residential real estate loan.

Loans secured by multi-family residential real estate generally involve a greater degree of credit risk than one- to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family residential real estate is typically dependent upon the successful operation of the related real estate property. If the cash flow from the project is reduced, the borrower's ability to repay the loan may be impaired.

Construction Loans. As of December 31, 2007, construction loans totaled $89.7 million or 17% of the Bank's total loan portfolio. Construction loans originated by the Bank are generally secured by permanent mortgage loans for the construction of owner-occupied residential real estate or to finance speculative construction secured by residential real estate or owner-operated commercial real estate. This portion of the Bank's loan portfolio predominantly consists of speculative loans, i.e., loans to builders who are speculating that they will be able to locate a purchaser for the underlying property prior to or shortly after the time construction has been completed.

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Construction loans are made to contractors who have sufficient financial strength and a proven track record, for the purpose of resale, as well as on a "pre-sold" basis. Construction loans made for the purpose of resale generally provide for interest only payments at floating rates and have terms of six months to fifteen months. Construction loans to a borrower who will occupy a home, or to a builder who has pre-sold the home, typically have loan to value ratios of up to 85%. Construction loans for speculative purposes, models, and commercial properties typically have loan to value ratios of up to 80%. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant.

Construction lending by its nature entails significant additional risks as compared with one-to four-family mortgage lending, attributable primarily to the fact that funds are advanced upon the security of the project under construction prior to its completion. As a result, construction lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower or guarantor to repay the loan. Because of these factors, the analysis of the prospective construction loan projects requires an expertise that is different in significant respects from that which is required for residential mortgage lending. The Bank attempts to address these risks through its underwriting and construction monitoring procedures.

Commercial Real Estate Loans. As of December 31, 2007, the Bank has commercial real estate loans totaling $176 million or 34% of the Bank's total loan portfolio. Commercial real estate loans are generally originated in amounts up to 80% of the appraised value of the mortgaged property. The majority of the Bank’s commercial real estate loans have been originated with adjustable rates of interest, the majority of which are quoted at a spread to the FHLB advance rate for the initial fixed rate period with subsequent adjustments at a spread to the Wall Street prime rate. The Bank's commercial real estate loans are generally permanent loans secured by improved property such as office buildings, retail stores, small shopping centers, medical offices, motels, churches and other non-residential buildings.

To originate commercial real estate loans, the Bank generally requires a mortgage and security interest in the subject real estate, personal guarantees of the principals, a security interest in the related personal property, and a standby assignment of rents and leases. The Bank has established its loan-to-one borrower limitation, which was $15.5 million as of December 31, 2007, as its maximum commercial real estate loan amount. Because of the small number of commercial real estate loans and the relationship of each borrower to the Bank, each such loan has differing terms and conditions applicable to the particular borrower.

Loans secured by commercial real estate are generally larger and involve a greater degree of risk than residential mortgage loans. Because payments on loans secured by commercial real estate are often dependent on successful operation or management of the properties, repayment of such loans may be subject, to a greater extent, to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks by careful underwriting, requiring personal guarantees, lending only to established customers and borrowers otherwise known by the Bank, and generally restricting such loans to its primary market area.

As of December 31, 2007, the Bank’s commercial real estate loan portfolio included approximately $29.5 million, or 6% of the Bank’s total loan portfolio, in loans to develop land into residential lots. The Bank utilizes its knowledge of the local market conditions and appraisals to evaluate the development cost and estimate projected lot prices and absorption rates to assess loans on residential subdivisions. The Bank typically loans up to 80% of the appraised value over terms up to two years. Development loans generally involve a greater degree of risk than residential mortgage loans because (1) the funds are advanced upon the security of the land which has a materially lower value prior to completion of the infrastructure required of a subdivision, (2) the cash flow available for debt repayment is a function of the sale of the individual lots, and (3) the amount of interest required to service the debt is a function of the time required to complete the development and sell the lots.

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Commercial Business Loans. As of December 31, 2007, the Bank has commercial business loans totaling $104 million or 20% of the Bank's total loan portfolio. Commercial business loans are generally secured by business assets, such as accounts receivable, equipment and inventory. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial business 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 business loans may be substantially dependent on the success of the business itself. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. The Bank expects to continue to expand its commercial business lending as opportunities present themselves.

Consumer and Other Loans. The Bank also offers other loans, primarily consisting of loans secured by certificates of deposit, consumer loans, home equity loans and automobile loans. As of December 31, 2007, the Bank has such loans totaling $25.6 million or 5% of the Bank's total loan portfolio. The Bank expects to continue to expand its consumer lending as opportunities present themselves.

Loan Approval Authority and Underwriting. All loans to borrowers with aggregate indebtedness exceeding $1.5 million must have the approval of the Bank's Loan Committee. The Loan Committee meets weekly to review and approve loans made within the scope of its authority.

For all loans originated by the Bank, upon receipt of a completed loan application from a prospective borrower, a credit report is requested, income, assets, and certain other information are verified, and, if necessary, additional financial information is requested. An appraisal of the real estate intended to secure the proposed loan is generally required and is performed by certified appraisers. It is the Bank's policy to obtain appropriate insurance protection on all real estate first mortgage loans. Borrowers generally must also obtain hazard insurance prior to closing and generally are required to advance funds for certain items such as real estate taxes, flood insurance and private mortgage insurance, when applicable.

Delinquencies, Non-Performing and Problem Assets.

Delinquent Loans. As of December 31, 2007, the Bank has eight loans 90 days or more past due with a principal balance of $6,215,533 and seventy-eight loans between 30 and 89 days past due with an aggregate principal balance of $8,242,217. The Bank generally does not accrue interest on loans past due more than 90 days.

The following table sets forth the Bank's loans that were accounted for on a non-accrual basis or 90 days or more delinquent at the dates indicated.

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Delinquency Summary	As of December 31,				
	2007	2006	2005	2004	2003
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis or contractually past due 90 days or more					
Mortgage Loans:					
One- to four-family	$ 929	$ 883	$ 452	770	703
Multi-family	-	-	-	-	-
Construction	459	1,780	-	-	-
Commercial real estate	5,850	-	131	158	-
	7,238	2,663	583	928	703
Non-mortgage loans:					
Commercial loans	-	44	-	-	-
Consumer and other loans	16	41	138	79	40
	16	85	138	79	40
Total non-accrual loans	7,254	2,748	721	1,007	743
Accruing loans which are contractually past maturity or past due 90 days or more:					
Mortgage Loans:					
One- to four-family	103	-	-	-	-
Multi-family	-	-	-	-	-
Construction	-	-	-	-	-
Commercial real estate	-	-	-	-	-
	103	-	-	-	-
Non-mortgage loans:					
Commercial loans	-	-	-	-	-
Consumer and other loans	-	-	-	-	-
	-	-	-	-	-
Total past maturity or past due accruing loans	103	-	-	-	-
Total accounted for on a non-accrual basis or contractually past maturity or 90 days or more past due	$ 7,357	$ 2,748	$ 721	1,007	743
Total accounted for on a non-accrual basis or contractually past maturity or 90 days or more past due as a percentage of net loans	1.43%	0.58%	0.17%	0.26%	0.22%
Total accounted for on a non-accrual basis or contractually past maturity or 90 days or more past due as a percentage of total assets	1.30%	0.52%	0.15%	0.23%	0.19%

Non-Performing Assets. Loans are reviewed on a regular basis and are placed on non-accrual status when, in the opinion of management, the collection of all interest at contractual rates becomes doubtful. Included as part of such review, mortgage loans are placed on non-accrual status generally when either principal or interest is more than 90 days past due. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income.

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Real estate acquired by the Bank as a result of foreclosure or by deed in lieu of foreclosure is deemed a foreclosed asset held for sale until such time as it is sold. When a foreclosed asset held for sale is acquired it is recorded at its estimated fair value, less estimated selling expenses. Valuations of such foreclosed assets are periodically performed by management, and any subsequent decline in estimated fair value is charged to operations.

The following table shows the principal amount of non-performing assets which are not performing under regulatory guidelines and all foreclosed assets, including assets acquired in settlement of loans and the resulting impact on interest income for the periods then ended.

Non-Performing Assets	As of December 31,				
	2007	2006	2005	2004	2003
Non-accrual loans:	(Dollars in Thousands)				
Mortgage loans:					
One- to four-family	$ 929	$ 883	$ 452	$ 770	$ 703
Multi-family	-	-	-	-	-
Construction	459	1,780	-	-	-
Commercial real estate	5,850	-	131	158	-
	7,238	2,663	583	928	703
Non-mortgage loans:					
Commercial loans	-	44	-	-	-
Consumer and other loans	16	41	138	79	40
	16	85	138	79	40
Total non-accrual loans	7,254	2,748	721	1,007	743
Real estate and other assets acquired in settlement of loans	727	173	27	78	6
Total non-performing assets	$ 7,981	$ 2,921	$ 748	$ 1,085	$ 749
Total non-accrual loans as a percentage of net loans	1.41%	0.57%	0.17%	0.26%	0.22%
Total non-performing assets as a percentage of total assets	1.41%	0.56%	0.16%	0.25%	0.19%
Impact on interest income for the period:					
Interest income that would have been recorded on non-accruing loans	$ 716	$ 69	$ 8	$ 23	$ 15

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Problem Assets. Federal regulations require that the Bank review and classify its assets on a regular basis to determine those assets considered to be of lesser quality. In addition, in connection with examinations of insured institutions, bank examiners have authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful, and loss. "Substandard assets" must have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. "Doubtful assets" have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values questionable, and there is a high possibility of loss. An asset classified "loss" is considered uncollectible and of such little value that continuance as an asset of the institution is not warranted. The regulations have also created a “special mention” category, described as assets which do not currently expose an insured institution to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving management's close attention. Federal regulations require the Bank to establish general allowances for loan losses from assets classified as substandard or doubtful. If an asset or portion thereof is classified as loss, the insured institution must either establish specific allowances for loan losses in the amount of 100% of the portion of the asset classified loss or charge off such amount. A portion of general loss allowances established to cover possible losses related to assets classified substandard or doubtful may be included in determining an institution's regulatory capital.

For management purposes, the Bank also designates certain loans for additional attention. Such loans are called “Special Mention” and have identified weaknesses, that if the situation deteriorates, the loans would merit a substandard classification.

The following table shows the aggregate amounts of the Bank's classified assets as of December 31, 2007.

Classification of Assets	Special Mention		Substandard		Doubtful		Loss		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
	(Dollars in Thousands)									
Loans:										
One- to four-family	-	$ -	14	$ 1,184	-	$ -	-	$ -	14	$ 1,184
Multi-family	1	1,235	1	6,996	-	-	-	-	2	8,231
Construction	1	2,322	6	513	-	-	-	-	7	2,835
Commercial real estate	6	3,373	2	5,897	-	-	-	-	8	9,270
Commercial	4	1,944	1	2,592	-	-	-	-	5	4,536
Land	-	-	-	-	-	-	-	-	-	-
Other loans	3	203	6	622	1	5	-	-	10	830
Total loans	15	9,077	30	17,804	1	5	-	-	46	26,886
Foreclosed assets held-for-sale:										
One- to four-family	-	-	2	334	-	-	-	-	2	334
Land and other assets	-	-	11	393	-	-	-	-	11	393
Total foreclosed assets	-	-	13	727	-	-	-	-	13	727
Total	15	$ 9,077	43	$ 18,531	1	$ 5	-	$ -	59	$ 27,613

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Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the risk inherent in its loan portfolio and the general economy. Such evaluation, which includes a review of all loans on which full collectibility may not be reasonably assured, considers among other matters, the estimated fair value of the underlying collateral, economic conditions, historical loan loss experience, and other factors that warrant recognition in providing for an adequate loan loss allowance. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and valuation of foreclosed assets held for sale. Such agencies may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

As of December 31, 2007 the Bank's total allowance for loan losses was $6.0 million or 1.14% of total loans. This allowance reflects not only management's determination to maintain an allowance for loan losses consistent with regulatory expectations for non-performing or problem assets, but also reflects the regional economy and the Bank's policy of evaluating the risks inherent in its loan portfolio.

For fiscal year 2007, the Bank experienced loan charge offs in excess of recoveries, and based on the loan portfolio review discussed above, elected to add to the allowance through a provision for loan loss, as shown in the table below. Management anticipates the need to continue adding to the allowance through charges to provision for loan losses as anticipated growth in the loan portfolio or other circumstances warrant.

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The following tables set forth certain information concerning the Bank's allowance for loan losses for the periods indicated.

Allowance for Loan Losses	Year ended December 31, 2007	2006	2005	2004	Six months ended December 31, 2003 (1)
	(Dollars in Thousands)				
Beginning balance	$ 5,784	5,400	4,537	3,886	2,775
Gross loan charge offs					
Mortgage Loans:					
One- to four-family	(56)	(286)	(22)	(188)	(41)
Multi-family	(1)	-	-	-	-
Construction	(317)	(29)	-	-	-
Commercial real estate	(49)	-	-	-	-
	(423)	(315)	(22)	(188)	(41)
Non-mortgage loans:					
Commercial loans	-	(206)	(12)	-	-
Consumer and other loans	(309)	(126)	(119)	(43)	(14)
	(309)	(126)	(119)	(43)	(14)
Total charge offs	(732)	(647)	(153)	(231)	(55)
Recoveries					
Mortgage Loans:					
One- to four-family	10	109	61	9	1
Multi-family	-	-	-	-	-
Construction	-	29	-	-	1
Commercial real estate	11	-	-	-	-
	21	138	61	9	2
Non-mortgage loans:					
Commercial loans	8	103	-	-	-
Consumer and other loans	42	40	10	9	2
	50	143	10	9	2
Total recoveries	71	281	71	18	4
Net loan charge-offs	(661)	(366)	(82)	(213)	(51)
Provision charged to expense	840	750	945	864	1,162
Ending balance	$ 5,963	5,784	5,400	4,537	3,886
Net charge-offs as a percentage of average loans, net	0.14%	0.08%	0.02%	0.07%	0.02%
Allowance for loan losses as a percentage of average loans, net	1.24%	1.28%	1.29%	1.39%	1.19%
Allowance for loan losses as a percentage of total non-performing loans	82%	210%	749%	451%	523%

(1) In 2003, the Company determined to change its fiscal year end from June 30 to a calendar year end of December 31. As a result, the Company reported a six-month transition period ended December 31, 2003 in order to change to this new calendar year end.

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Allocation of Allowance for Loan Losses

The following table shows the amount of the allowance allocated to the mortgage and non-mortgage loan categories and the respective percent of that loan category to total loans.

Allocation of Allowance for Loan Losses

	As of December 31,									
	2007		2006		2005		2004		2003	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Mortgage Loans	$ 4,484	75%	4,512	78%	4,266	79%	3,630	80%	3,342	86%
Non-Mortgage Loans	1,479	25%	1,272	22%	1,134	21%	907	20%	544	14%
Total	$ 5,963									