

TF FINANCIAL CORP  
Form 10-Q  
November 14, 2011

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the period ended September 30, 2011

- or -

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-24168

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

Pennsylvania  
(State or Other Jurisdiction of Incorporation  
or Organization)

74-2705050  
(I.R.S. Employer Identification No.)

3 Penns Trail, Newtown, Pennsylvania  
(Address of Principal Executive Offices)

18940  
(Zip Code)

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

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  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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

Large accelerated filer

Accelerated filer

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Non-accelerated filer   
(Do not check if a smaller reporting  
company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: November 14, 2011

Class	Outstanding
\$.10 par value common stock	2,826,397 shares

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Exhibits

31.1	<u>Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of CFO pursuant of Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.	<u>Certification pursuant of Section 906 of the Sarbanes-Oxley Act of 2002</u>

The following Exhibits are being furnished as part of this report:

101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document



## TF Financial Corporation and Subsidiaries

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2011	December 31, 2010
	(in thousands)	
<b>ASSETS</b>		
Cash and cash equivalents	\$14,475	\$7,437
Investment securities	120,483	127,490
Loans receivable, net	504,036	501,528
Loans receivable held for sale	1,696	130
Federal Home Loan Bank stock—at cost	8,060	9,401
Accrued interest receivable	2,580	2,738
Premises and equipment, net	6,658	6,797
Goodwill	4,324	4,324
Bank-owned life insurance	18,349	17,868
Other assets	14,507	14,044
<b>TOTAL ASSETS</b>	<b>\$695,168</b>	<b>\$691,757</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Deposits	\$551,678	\$550,135
Borrowings from the Federal Home Loan Bank	59,500	61,987
Advances from borrowers for taxes and insurance	1,433	2,166
Accrued interest payable	1,307	1,784
Other liabilities	3,751	2,269
<b>Total liabilities</b>	<b>617,669</b>	<b>618,341</b>
<b>Stockholders' equity</b>		
Preferred stock, no par value; 2,000,000 shares authorized at September 30, 2011 and December 31, 2010, none issued	-	-
Common stock, \$0.10 par value; 10,000,000 shares authorized, 5,290,000 shares issued, 2,824,034 and 2,822,449 shares outstanding at September 30, 2011 and December 31, 2010, respectively, net of shares in treasury of 2,465,966 and 2,467,551, respectively.	529	529
Additional paid-in capital	54,104	53,964
Unearned ESOP shares	(1,126 )	(1,217 )
Treasury stock-at cost	(51,189 )	(51,220 )
Retained earnings	72,747	70,749
Accumulated other comprehensive income	2,434	611
<b>Total stockholders' equity</b>	<b>77,499</b>	<b>73,416</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$695,168</b>	<b>\$691,757</b>

The accompanying notes are an integral part of these statements

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## TF Financial Corporation and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
	(in thousands, except per share data)			
Interest income				
Loans, including fees	\$6,667	\$7,020	\$19,946	\$21,472
Investment securities				
Fully taxable	879	1,020	2,648	3,160
Exempt from federal taxes	362	310	1,080	913
Interest-bearing deposits and other	-	-	1	2
<b>TOTAL INTEREST INCOME</b>	<b>7,908</b>	<b>8,350</b>	<b>23,675</b>	<b>25,547</b>
Interest expense				
Deposits	1,430	1,757	4,328	5,593
Borrowings	473	731	1,537	2,372
<b>TOTAL INTEREST EXPENSE</b>	<b>1,903</b>	<b>2,488</b>	<b>5,865</b>	<b>7,965</b>
<b>NET INTEREST INCOME</b>	<b>6,005</b>	<b>5,862</b>	<b>17,810</b>	<b>17,582</b>
Provision for loan losses	528	1,180	2,878	2,741
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,477</b>	<b>4,682</b>	<b>14,932</b>	<b>14,841</b>
Non-interest income				
Service fees, charges and other operating income	298	404	1,242	1,296
Bank-owned life insurance	160	170	481	509
Gain on sale of investments	-	-	210	7
Gain on sale of loans	125	353	292	465
Loss on foreclosed real estate	(254 )	-	(254 )	(137 )
<b>TOTAL NON-INTEREST INCOME</b>	<b>329</b>	<b>927</b>	<b>1,971</b>	<b>2,140</b>
Non-interest expense				
Employee compensation and benefits	2,584	2,269	7,952	7,636
Occupancy and equipment	699	774	2,253	2,256
Professional fees	263	196	1,065	680
Marketing and advertising	88	152	257	392
FDIC insurance premiums	142	233	526	686
Other operating	636	603	1,945	1,760

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TOTAL NON-INTEREST EXPENSE	4,412	4,227	13,998	13,410
INCOME BEFORE INCOME TAXES	1,394	1,382	2,905	3,571
Income taxes	314	373	508	878
NET INCOME	\$1,080	\$1,009	\$2,397	\$2,693
Earnings per share—basic	\$0.40	\$0.38	\$0.89	\$1.01
Earnings per share—diluted	\$0.40	\$0.38	\$0.89	\$1.01
Dividends paid per share	\$0.05	\$0.19	\$0.15	\$0.58

The accompanying notes are an integral part of these statements



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## TF Financial Corporation and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)For the nine months  
ended  
September 30,  
2011            2010  
(in thousands)

## OPERATING ACTIVITIES

Net income	\$2,397	\$2,693
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization and impairment adjustment of mortgage loan servicing rights	296	418
Premiums and discounts on investment securities, net	87	59
Premiums and discounts on mortgage-backed securities, net	128	63
Deferred loan origination costs, net	122	114
Provision for loan losses	2,878	2,741
Depreciation of premises and equipment	647	645
Increase in value of bank-owned life insurance	(481 )	(509 )
Stock based compensation	262	231
Proceeds from sale of loans originated for sale	15,748	27,326
Origination of loans held for sale	(17,156 )	(27,087 )
Loss on foreclosed real estate	254	137
Gain on sale of:		
Investments	(210 )	(7 )
Loans held for sale	(292 )	(465 )
(Increase) decrease in:		
Accrued interest receivable	158	118
Other assets	900	411
Increase (decrease) in:		
Accrued interest payable	(477 )	(1,021 )
Other liabilities	533	(1,426 )
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>5,794</b>	<b>4,441</b>

## INVESTING ACTIVITIES

Loan originations	(76,036 )	(59,604 )
Loan principal payments	68,123	65,106
Proceeds from sale of foreclosed real estate	724	799
Proceeds from maturities of investment securities available for sale	3,860	590
Principal repayments on mortgage-backed securities held to maturity	482	462
Principal repayments on mortgage-backed securities available for sale	20,990	20,649
Proceeds from sale of investment securities available for sale	3,534	60
Proceeds from sale of mortgage-backed securities available for sale	1,518	-
Purchase of investment securities available for sale	(4,112 )	(8,681 )
Purchase of mortgage-backed securities available for sale	(16,596 )	(13,995 )
Purchase of premises and equipment	(508 )	(1,910 )
Redemption of Federal Home Loan Bank stock	1,341	-

NET CASH PROVIDED BY INVESTING ACTIVITIES

3,320

3,476

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	For the nine months ended September 30,	
	2011	2010
	(in thousands)	
<b>FINANCING ACTIVITIES</b>		
Net increase (decrease) in customer deposits	1,543	(154 )
Proceeds of long-term FHLB borrowings	6,573	12,884
Repayment of long-term FHLB borrowings	(19,944 )	(24,454 )
Net increase in short term FHLB borrowings	10,884	-
Net decrease in advances from borrowers for taxes and insurance	(733 )	(746 )
Exercise of stock options	-	177
Tax benefit arising from stock compensation	-	17
Common stock dividends paid	(399 )	(1,526 )
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>(2,076 )</b>	<b>(13,802 )</b>
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>7,038</b>	<b>(5,885 )</b>
Cash and cash equivalents at beginning of period	7,437	12,801
Cash and cash equivalents at end of period	\$ 14,475	\$ 6,916
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for:		
Interest on deposits and borrowings	\$ 6,342	\$ 8,986
Income taxes	\$ 300	\$ 1,462
Non-cash transactions:		
Capitalization of mortgage servicing rights	\$ 136	\$ 231
Transfers from loans to foreclosed real estate	\$ 2,405	\$ 1,793
Securities available for sale purchased not settled	\$ -	\$ 175

The accompanying notes are an integral part of these statements

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TF FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 - PRINCIPLES OF CONSOLIDATION

The consolidated financial statements as of September 30, 2011 (unaudited) and December 31, 2010 and for the nine month periods ended September 30, 2011 and 2010 (unaudited) include the accounts of TF Financial Corporation (the “Company”) and its wholly owned subsidiaries Third Federal Bank (the “Bank”), TF Investments Corporation and Penns Trail Development Corporation. The accompanying consolidated balance sheet at December 31, 2010, has been derived from the audited consolidated balance sheet but does not include all of the information and notes required by accounting principles generally accepted in the United States of America (“US GAAP”) for complete financial statements. The Company’s business is conducted principally through the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

## NOTE 2 - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements were prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all of the disclosures or footnotes required by US GAAP. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the consolidated financial statements have been included. The results of operations for the period ended September 30, 2011 are not necessarily indicative of the results which may be expected for the entire fiscal year or any other period. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

## NOTE 3 - CONTINGENCIES

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. In the opinion of management, the resolution of this litigation, if any, would not have a material adverse effect on the Company’s consolidated financial position or results of operations.

## NOTE 4 - OTHER COMPREHENSIVE INCOME

Comprehensive income is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Total comprehensive income was \$2.1 million and \$1.8 million for the three months ended September 30, 2011 and 2010. The components of other comprehensive income are as follows for the three months ended:

	September 30, 2011		
	Before tax amount	Tax (expense)	Net of tax amount
	(in thousands)		
Unrealized gains on securities			
Unrealized holding gains arising during period	\$1,524	\$(518 )	\$1,006
Pension plan benefit adjustment related to actuarial losses	30	(11 )	19
Other comprehensive income, net	\$1,554	\$(529 )	\$1,025

September 30, 2010

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	Before tax amount	Tax (expense) (in thousands)	Net of tax amount
Unrealized gains on securities			
Unrealized holding gains arising during period	\$1,126	\$(381 )	\$745
Pension plan benefit adjustment related to actuarial losses	42	(14 )	28
Other comprehensive income, net	\$1,168	\$(395 )	\$773

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Total comprehensive income was \$4.2 million and \$3.9 million for the nine months ended September 30, 2011 and 2010. The components of other comprehensive income are as follows for the nine months ended:

	September 30, 2011		
	Before tax amount	Tax (expense) (in thousands)	Net of tax amount
Unrealized gains on securities			
Unrealized holding gains arising during period	\$2,884	\$(980)	\$1,904
Reclassification adjustment for gains realized in net income	(210)	71	(139)
Pension plan benefit adjustment related to prior service costs and actuarial losses	88	(30)	58
Other comprehensive income, net	\$2,762	\$(939)	\$1,823
	September 30, 2010		
	Before tax amount	Tax (expense) (in thousands)	Net of tax amount
Unrealized gains on securities			
Unrealized holding gains arising during period	\$1,720	\$(586)	\$1,134
Reclassification adjustment for gains realized in net income	(7)	2	(5)
Pension plan benefit adjustment related to actuarial losses	117	(39)	78
Other comprehensive income, net	\$1,830	\$(623)	\$1,207

## NOTE 5—EARNINGS PER SHARE

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per share computations (dollars in thousands, except share and per share data):

	Three months ended September 30, 2011		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount
Basic earnings per share			
Income available to common stockholders	\$1,080	2,704,350	\$0.40
Effect of dilutive securities			
Stock options and grants	-	818	-
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$1,080	2,705,168	\$0.40
	Nine months ended September 30, 2011		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount

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	Income (numerator)	shares (denominator)	Per share Amount
<b>Basic earnings per share</b>			
Income available to common stockholders	\$2,397	2,700,845	\$0.89
<b>Effect of dilutive securities</b>			
Stock options and grants	-	716	-
<b>Diluted earnings per share</b>			
Income available to common stockholders plus effect of dilutive securities	\$2,397	2,701,561	\$0.89

There were 64,407 options to purchase shares of common stock at a price range of \$24.12 to \$32.51 per share which were outstanding during the three and nine months ended September 30, 2011 that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.

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	Three months ended September 30, 2010		
	Income	Weighted	Per share
	(numerator)	average	Amount
		shares	
		(denominator)	
Basic earnings per share			
Income available to common stockholders	\$ 1,009	\$ 2,687,439	\$0.38
Effect of dilutive securities			
Stock options and grants	-	-	-
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$ 1,009	\$ 2,687,439	\$0.38
	Nine months ended September 30, 2010		
	Income	Weighted	Per share
	(numerator)	average	Amount
		shares	
		(denominator)	
Basic earnings per share			
Income available to common stockholders	\$2,693	\$ 2,678,920	\$1.01
Effect of dilutive securities			
Stock options and grants	-	-	-
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$2,693	\$ 2,678,920	\$1.01

There were 203,574 options to purchase shares of common stock at a price range of \$19.33 to \$32.51 per share which were outstanding during the three and nine months ended September 30, 2010 that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares.



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## NOTE 6—INVESTMENT SECURITIES

The amortized cost, gross unrealized gains and losses, and fair value of the Company's investment securities at September 30, 2011 and December 31, 2010, are summarized as follows:

	Amortized cost	September 30, 2011		Fair value
		Gross unrealized gains (in thousands)	Gross unrealized losses	
Available for sale				
U.S. Government and federal agencies	\$5,992	\$58	\$-	\$6,050
State and political subdivisions	47,521	3,885	(2 )	51,404
Residential mortgage-backed securities issued by quasi-governmental agencies	48,973	1,806	-	50,779
Residential mortgage-backed securities privately issued	9,367	208	(15 )	9,560
Total investment securities available for sale	111,853	5,957	(17 )	117,793
Held to maturity				
Residential mortgage-backed securities issued by quasi-governmental agencies	2,690	335	-	3,025
Total investment securities	\$114,543	\$6,292	\$(17 )	\$120,818
	Amortized cost	December 31, 2010		Fair value
		Gross unrealized gains (in thousands)	Gross unrealized losses	
Available for sale				
U.S. Government and federal agencies	\$6,000	\$59	\$-	\$6,059
Corporate debt securities	3,340	223	-	3,563
State and political subdivisions	47,348	1,120	(260 )	48,208
Residential mortgage-backed securities issued by quasi-governmental agencies	50,942	1,950	(6 )	52,886
Residential mortgage-backed securities privately issued	13,425	224	(44 )	13,605
Total investment securities available for sale	121,055	3,576	(310 )	124,321
Held to maturity				
Residential mortgage-backed securities issued by quasi-governmental agencies	3,169	341	-	3,510
Total investment securities	\$124,224	\$3,917	\$(310 )	\$127,831

Gross realized gains were \$210,000 for the nine months ended September 30, 2011. These gains resulted from proceeds from the sale of investment and mortgage-backed securities of \$5.1 million. Gross realized gains were \$7,000 for the nine months ended September 30, 2010. These gains resulted from proceeds from the sale of an investment in equity securities of \$60,000.



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The amortized cost and fair value of investment and mortgage-backed securities, by contractual maturity, are shown below.

	September 30, 2011			
	Available for sale Amortized cost	Fair value	Held to maturity Amortized cost	Fair value
	(in thousands)			
Investment securities				
Due in one year or less	\$424	\$431	\$-	\$-
Due after one year through five years	10,405	10,845	-	-
Due after five years through 10 years	26,821	28,758	-	-
Due after ten years	15,863	17,420	-	-
	53,513	57,454	-	-
Mortgage-backed securities	58,340	60,339	2,690	3,025
Total investment and mortgage-backed securities	\$111,853	\$117,793	\$2,690	\$3,025

The table below indicates the length of time individual securities have been in a continuous unrealized loss position at September 30, 2011:

Description of securities	Number of securities	Less than 12 months		12 months or longer		Total	
		Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
		(in thousands)					
State and political subdivisions	1	\$-	\$-	\$173	\$(2)	\$173	\$(2)
Residential mortgage-backed securities issued by quasi-governmental agencies	1	435	(1)	-	-	435	(1)
Residential mortgage-backed securities privately issued	3	3,985	(14)	-	-	3,985	(14)
Total temporarily impaired securities	5	\$4,420	\$(15)	\$173	\$(2)	\$4,593	\$(17)

The table below indicates the length of time individual securities have been in a continuous unrealized loss position at December 31, 2010:

Description of securities	Number of securities	Less than 12 months		12 months or longer		Total	
		Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
		(in thousands)					

State and political subdivisions	17	\$ 14,210	\$ (260 )	\$ -	\$ -	\$ 14,210	\$ (260 )
Residential mortgage-backed securities issued by quasi-governmental agencies	1	3,027	(6 )	-	-	3,027	(6 )
Residential mortgage-backed securities privately issued	3	7,048	(44 )	-	-	7,048	(44 )
Total temporarily impaired securities	21	\$ 24,285	\$ (310 )	\$ -	\$ -	\$ 24,285	\$ (310 )

On a quarterly basis, temporarily impaired securities are evaluated to determine whether such impairment is an other-than-temporary impairment (“OTTI”). The Company has performed this evaluation and has determined that the unrealized losses at September 30, 2011 and December 31, 2010, respectively, are not considered other-than-temporary but are the result of changes in interest rates, and are therefore reflected in other comprehensive income.

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## NOTE 7—LOANS RECEIVABLE

Loans receivable are summarized as follows:

	September 30, 2011	December 31, 2010
	(in thousands)	
Held for investment:		
First mortgage loans		
Secured by one-to four-family residences	\$ 278,325	\$ 269,077
Secured by non-residential properties or non—owner occupied residential properties	145,099	137,307
Construction loans	18,636	18,799
Total first mortgage loans	442,060	425,183
Other loans		
Commercial-business, real estate secured	18,454	26,603
Commercial-business, non-real estate secured	4,587	5,575
Home equity and second mortgage	45,478	49,430
Other consumer	2,056	2,407
Total other loans	70,575	84,015
Total loans	512,635	509,198
Net deferred loan origination costs and unamortized premiums	987	658
Less allowance for loan losses	(9,586 )	(8,328 )
Total loans receivable	\$ 504,036	\$ 501,528
Held for sale:		
First mortgage loans		
Secured by one-to four-family residences	\$ 1,696	\$ 130

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The following table presents the composition of the commercial loan portfolio by credit quality indicators:

Commercial credit exposure-credit risk profile by internally assigned grade  
September 30, 2011

	Pass	Special mention	Substandard (in thousands)	Doubtful	Total
Secured by non-residential properties or non—owner occupied residential properties	\$ 125,786	\$ 12,920	\$ 6,393	\$ -	\$ 145,099
Construction loans	4,445	5,099	9,092	-	18,636
Commercial-business, real estate secured	7,159	102	11,193	-	18,454
Commercial-business, non-real estate secured	4,426	-	161	-	4,587
<b>Total</b>	<b>\$ 141,816</b>	<b>\$ 18,121</b>	<b>\$ 26,839</b>	<b>\$ -</b>	<b>\$ 186,776</b>

Commercial credit exposure-credit risk profile by internally assigned grade  
December 31, 2010

	Pass	Special mention	Substandard (in thousands)	Doubtful	Total
Secured by non-residential properties or non—owner occupied residential properties	\$ 108,484	\$ 19,299	\$ 9,524	\$ -	\$ 137,307
Construction loans	3,482	6,269	9,048	-	18,799
Commercial-business, real estate secured	15,778	1,007	9,818	-	26,603
Commercial-business, non-real estate secured	5,531	-	-	44	5,575
<b>Total</b>	<b>\$ 133,275</b>	<b>\$ 26,575</b>	<b>\$ 28,390</b>	<b>\$ 44</b>	<b>\$ 188,284</b>

In order to assess and monitor the credit risk associated with commercial loans, the Company employs a risk rating methodology whereby each commercial loan is initially assigned a risk grade. At least annually, all risk ratings are reviewed in light of information received such as tax returns, rent rolls, cash flow statements, appraisals, and any other information which may affect the then current risk rating, which is adjusted upward or downward as needed. At the end of each quarter the risk ratings are summarized and become a component of the evaluation of the allowance for loan losses. The Company's risk rating definitions mirror those promulgated by banking regulators and are as follows:

**Pass:** Good quality loan characterized by satisfactory liquidity; reasonable debt capacity and coverage; acceptable management in all critical positions and normal operating results for its peer group. The Company has grades 1 through 6 within the Pass category which reflect the increasing amount of attention paid to the individual loan because of, among other things, trends in debt service coverage, management weaknesses, or collateral values.

**Special mention:** A loan that has potential weaknesses that deserves management's close attention. Although the loan is currently protected, if left uncorrected, potential weaknesses may result in deterioration of the loan's repayment prospects or in the borrower's future credit position. Potential weaknesses include: weakening financial condition; an unrealistic repayment program; inadequate sources of funds; lack of adequate collateral; credit information; or

documentation. There is currently the capacity to meet interest and principal payments, but further adverse business, financial, or economic conditions may impair capacity or willingness to pay interest and repay principal.

Substandard: A loan that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Although no loss of principal or interest is presently apparent, there is the distinct possibility that a partial loss of interest and/or principal will be sustained if the deficiencies are not corrected. There is a current identifiable vulnerability to default and the dependence upon favorable business, financial, or economic conditions to meet timely payment of interest and repayment of principal.

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Doubtful: A loan which has all the weaknesses inherent in a substandard asset with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors which may work to strengthen the asset, classification as an estimated loss is deferred until a more exact status is determined. Pending factors include: proposed merger, acquisition, liquidation, capital injection, perfecting liens on additional collateral, and refinancing plans.

Loss: Loans which are considered uncollectible and have been charged off. The Company has charged-off all loans classified as loss.

Loans classified as special mention, substandard or doubtful are evaluated for potential impairment. All impaired loans are placed on non-accrual status and are classified as substandard or doubtful.

The following table presents the composition of the residential mortgage and consumer loan portfolios by credit quality indicators:

Mortgage and consumer credit exposure-credit risk profile by payment activity  
September 30, 2011

	Performing	Non-performing (in thousands)	Total
Secured by one-to four-family residences	\$ 273,181	\$ 5,144	\$ 278,325
Home equity and second mortgage	45,202	276	45,478
Other	2,056	-	2,056
Total	\$ 320,439	\$ 5,420	\$ 325,859

Mortgage and consumer credit exposure-credit risk profile by payment activity  
December 31, 2010

	Performing	Non-performing (in thousands)	Total
Secured by one-to four-family residences	\$ 265,459	\$ 3,618	\$ 269,077
Home equity and second mortgage	48,018	1,412	49,430
Other	2,404	3	2,407
Total	\$ 315,881	\$ 5,033	\$ 320,914

In order to assess and monitor the credit risk associated with one-to four-family residential loans and consumer loans which include second mortgage loans and home equity secured lines of credit, the Company relies upon the payment status of the loan. Mortgage and other consumer loans 90 days or more past due are placed on non-accrual status and evaluated for impairment on a pooled basis with the exception of loans with balances in excess of \$1 million. An individual impairment analysis is performed using a recent appraisal or current sales contract for mortgage and consumer loans with balances in excess of \$1 million that are 90 days or more past due.

The following table presents non-performing loans including impaired loans and loan balances 90 days or more past due for which the accrual of interest has been discontinued by class at:



	September 30, 2011	December 31, 2010
	(in thousands)	
Secured by one-to four-family residences	\$ 5,144	\$ 3,618
Secured by non-residential properties or non—owner occupied residential properties	1,214	4,993
Construction loans	5,707	4,307
Commercial-business, real estate secured	4,601	4,601
Commercial-business, non-real estate secured	161	44
Home equity and second mortgage	276	1,412
Other consumer	-	3
Total non-performing loans	\$ 17,103	\$ 18,978
Total loans past due 90 days as to interest or principal and accruing interest	\$ -	\$ -

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The following table presents loans individually evaluated for impairment by class:

	September 30, 2011				Interest income recognized
	Recorded investment	Unpaid principal balance	Related allowance (in thousands)	Average recorded investment	
With an allowance recorded:					
Secured by one-to four- family residences	\$ 1,252	\$ 1,252	\$ 217	\$ 626	\$-
Secured by non-residential properties or non-owner occupied residential properties	-	-	-	1,091	-
Construction loans	5,707	5,707	2,777	5,252	-
Commercial-business, real estate secured	2,605	2,605	846	2,605	-
Commercial-business, non-real estate secured	161	161	80	86	-
With no allowance recorded:					
Secured by one-to four- family residences	1,874	1,874	-	1,276	-
Secured by non-residential properties or non-owner occupied residential properties	910	910	-	1,648	-
Construction loans	-	-	-	210	-
Commercial-business, real estate secured	1,996	1,996	-	1,996	-
Total	\$ 14,505	\$ 14,505	\$ 3,920	\$ 14,790	\$-

	December 31, 2010				Interest income recognized
	Recorded investment	Unpaid principal balance	Related allowance (in thousands)	Average recorded investment	
With an allowance recorded:					
Secured by non-residential properties or non-owner occupied residential properties	\$ 1,855	\$ 1,855	\$ 218	\$ 925	\$-
Construction loans	3,887	3,887	1,627	3,887	-
Commercial-business, real estate secured	2,605	2,605	373	1,563	-
Commercial-business, non-real estate secured	44	44	44	18	-
With no allowance recorded:					
Secured by non-residential	2,830	2,830	-	3,479	-

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properties or non-owner occupied residential properties					
Construction loans	420	420	-	492	-
Commercial-business, real estate secured	1,996	1,996	-	4,717	-
Commercial-business, non-real estate secured	-	-	-	22	-
Total	\$ 13,637	\$ 13,637	\$ 2,262	\$ 15,103	\$ -

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The following table presents the contractual aging of delinquent loans by class at September 30, 2011:

	Current	30-59 Days past due	60-89 Days past due	Loans past due 90 days or more (in thousands)	Total past due	Total loans	Recorded investment over 90 days and accruing interest
Secured by one-to four- family residences	\$274,269	\$244	\$-	\$3,812	\$4,056	\$278,325	\$-
Secured by non-residential properties or non—owner occupied residential properties	143,885	-	-	1,214	1,214	145,099	-
Construction loans	14,749	-	-	3,887	3,887	18,636	-
Commercial-business, real estate secured	13,853	-	-	4,601	4,601	18,454	-
Commercial-business, non- real estate secured	4,581	-	-	6	6	4,587	-
Home equity and second mortgage	45,142	27	33	276	336	45,478	-
Other	2,044	12	-	-	12	2,056	-
Total	\$498,523	\$283	\$33	\$13,796	\$14,112	\$512,635	\$-

The following table presents the contractual aging of delinquent loans by class at December 31, 2010:

	Current	30-59 Days past due	60-89 Days past due	Loans past due 90 days or more (in thousands)	Total past due	Total loans	Recorded investment over 90 days and accruing interest
Secured by one-to four- family residences	\$267,885	\$424	\$26	\$742	\$1,192	\$269,077	\$-
Secured by non-residential properties or non—owner	131,566	748	754	4,239	5,741	137,307	-

occupied residential properties							
Construction loans	14,492	-	-	4,307	4,307	18,799	-
Commercial-business, real estate secured	18,877	3,125	-	4,601	7,726	26,603	-
Commercial-business, non- real estate secured	5,531	-	-	44	44	5,575	-
Home equity and second mortgage	48,285	60	9	1,076	1,145	49,430	-
Other	2,381	13	10	3	26	2,407	-
Total	\$489,017	\$4,370	\$799	\$15,012	\$20,181	\$509,198	\$-

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Activity in the allowance for loan losses for the nine months ended September 30, 2011 is summarized as follows:

	Balance January 1, 2011	Provision	Charge- offs (in thousands)	Recoveries	Balance September 30, 2011
Secured by one-to four- family residences	\$ 1,839	\$ (10 )	\$ (172 )	\$ 2	\$ 1,659
Secured by non-residential properties or non—owner occupied residential properties	2,124	1,132	(1,186 )	-	\$ 2,070
Construction loans	2,479	1,148	-	1	\$ 3,628
Commercial-business, real estate secured	974	364	-	-	\$ 1,338
Commercial-business, non-real estate secured	77	197	(44 )	6	\$ 236
Home equity and second mortgage	607	82	(221 )		\$ 468
Other consumer	16	9	(12 )	6	\$ 19
Unallocated	212	(44 )	-	-	\$ 168
<b>Total</b>	<b>\$ 8,328</b>	<b>\$ 2,878</b>	<b>\$ (1,635 )</b>	<b>\$ 15</b>	<b>\$ 9,586</b>

Despite the above allocation, the allowance for credit losses is general in nature and is available to absorb losses from any portfolio segment.

Changes in the allowance for credit losses for the nine months ended September 30, 2010 were as follows:

	2010 (in thousands)
Balance at January 1,	\$ 5,215
Provision charged to income	2,741
Charge-offs:	
Secured by one-to-four family residence	(10 )
Secured by non-residential properties or non-owner occupied	(174 )
Commercial-business, non-real estate secured	(146 )
Home equity and second mortgage	(28 )
Recoveries:	
Other consumer	8
Balance at September 30,	\$ 7,606

Loans receivable includes certain loans that have been modified in a trouble debt restructuring (TDR), where economic concessions have been granted to borrowers experiencing financial difficulties. The objective for granting the concessions is to maximize the recovery of the investment in the loan and may include reductions in the interest rate, payment extensions, forgiveness of interest or principal, forbearance or other actions. TDRs are classified as nonperforming at the time of restructuring and typically return to performing status after considering the borrower's repayment performance for a reasonable period of time, usually six months.

Loans modified in a TDR are evaluated for impairment similar to other impaired loans based on the present value of expected cash flows or the fair value of the underlying collateral less selling costs for collateral dependent loans. If the value of the modified loan is less than the recorded investment in the loan, impairment is recognized through an increase to the allowance for loan losses. In periods subsequent to modification, TDRs are evaluated for possible additional impairment.

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The following table presents loans classified as TDRs segregated by class for the periods indicated:

	Trouble Debt Restructuring					
	For the three months ended September 30, 2011			For the nine months ended September 30, 2011		
	Number of Contracts	Pre-Modification	Post	Number of Contracts	Pre-Modification	Post
		Outstanding Recorded Investment (in thousands)	Outstanding Recorded Investment (in thousands)		Outstanding Recorded Investment (in thousands)	Outstanding Recorded Investment (in thousands)
Secured by one-to four-family residences	2	\$ 510	\$ 507	2	\$ 510	\$ 507
Total	2	\$ 510	\$ 507	2	\$ 510	\$ 507

There were no troubled debt restructurings that subsequently defaulted during the three and nine-month periods end September 30, 2011.

The following tables present the ending balance of the allowance for loan losses and ending loan balance by portfolio by class based on impairment method as of September 30, 2011:

Allowance	Evaluated for impairment		Total
	Individually	Collectively (in thousands)	
Secured by one-to-four family residences	\$217	\$ 1,442	\$ 1,659
Secured by non-residential properties or non—owner occupied residential properties	-	2,070	2,070
Construction loans	2,777	851	3,628
Commercial-business, real estate secured	846	492	1,338
Commercial-business, non-real estate secured	80	156	236
Home equity and second mortgage	-	468	468
Other consumer	-	19	19
Unallocated	-	168	168
Total	\$3,920	\$ 5,666	\$ 9,586

Loan balance	Evaluated for impairment		Total
	Individually	Collectively (in thousands)	
Secured by one-to-four family residences	\$3,126	\$ 275,199	\$ 278,325
Secured by non-residential properties or non—owner occupied residential properties	910	144,189	145,099
Construction loans	5,707	12,929	18,636
Commercial-business, real estate secured	4,601	13,853	18,454



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Commercial-business, non-real estate secured	161	4,426	4,587
Home equity and second mortgage	-	45,478	45,478
Other consumer	-	2,056	2,056
Total	\$14,505	\$498,130	\$512,635

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The following tables present the ending balance of the allowance for loan losses and ending loan balance by portfolio by class based on impairment method as of December 31, 2010:

Allowance	Evaluated for impairment		Total
	Individually	Collectively (in thousands)	
Secured by one-to-four family residences	\$-	\$ 1,839	\$ 1,839
Secured by non-residential properties or non—owner occupied residential properties	218	1,906	2,124
Construction loans	1,627	852	2,479
Commercial-business, real estate secured	373	601	974
Commercial-business, non-real estate secured	44	33	77
Home equity and second mortgage	-	607	607
Other consumer	-	16	16
Unallocated	-	212	212
Total	\$2,262	\$ 6,066	\$ 8,328

Loan balance	Evaluated for impairment		Total
	Individually	Collectively (in thousands)	
Secured by one-to-four family residences	\$-	\$ 269,077	\$ 269,077
Secured by non-residential properties or non—owner occupied residential properties	4,685	132,622	137,307
Construction loans	4,307	14,492	18,799
Commercial-business, real estate secured	4,601	22,002	26,603
Commercial-business, non-real estate secured	44	5,531	5,575
Home equity and second mortgage	-	49,430	49,430
Other consumer	-	2,407	2,407
Total	\$13,637	\$ 495,561	\$ 509,198

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## NOTE 8- FAIR VALUE MEASUREMENTS

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement hierarchy has been established for inputs in valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The fair value hierarchy levels are summarized below:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are inputs that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable and contain assumptions of the party assessing the fair value of the asset or liability.

Determination of the appropriate level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement for the instrument or security. Assets measured at fair value on a recurring basis segregated by fair value hierarchy level are summarized below:

At September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2011
(in thousands)				
<b>Assets</b>				
Investment securities available for sale				
U.S. Government and federal agencies	\$ -	\$ 6,050	\$ -	\$ 6,050
State and political subdivisions	-	51,404	-	51,404
Residential mortgage-backed securities issued by quasi-governmental agencies	-	50,779	-	50,779
Residential real estate mortgage - backed securities privately issued	-	9,560	-	9,560
<b>Total investment securities available for sale</b>	<b>\$ -</b>	<b>\$ 117,793</b>	<b>\$ -</b>	<b>\$ 117,793</b>
<b>Liabilities</b>				
Forward loan sales	\$ -	\$ -	\$ 21	\$ 21



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At December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2010
	(in thousands)			
Assets				
Investment securities available for sale				
U.S. Government and federal agencies	\$ -	\$ 6,059	\$ -	\$ 6,059
Corporate debt securities		3,563	-	3,563
State and political subdivisions	-	48,208	-	48,208
Residential mortgage-backed securities issued by quasi-governmental agencies	-	52,886	-	52,886
Residential real estate mortgage - backed securities privately issued	-	13,605	-	13,605
Total investment securities available for sale	\$ -	\$ 124,321	\$ -	\$ 124,321
Forward loan sales	\$ -	\$ -	\$ 3	\$ 3

Investment securities available for sale and mortgage-backed securities available for sale are valued primarily by a third party pricing agent. U.S. Government and federal agency and corporate debt securities are primarily priced through a multi-dimensional relational model, a Level 2 hierarchy, which incorporates dealer quotes and other market information including, defined sector breakdown, benchmark yields, base spread, yield to maturity, and corporate actions. State and political subdivision securities are also valued within the Level 2 hierarchy using inputs with a series of matrices that reflect benchmark yields, ratings updates, and spread adjustments. Mortgage-backed securities include FHLMC, GNMA, and FNMA certificates and privately issued real estate mortgage investment conduits which are valued under a Level 2 hierarchy using a matrix correlation to benchmark yields, spread analysis, and prepayment speeds.

The fair value of forward loan sales is determined at the time the underlying loan is identified as held for sale with changes in fair value correlated to the change in secondary market loan pricing. The value is adjusted to reflect the Company's historical loan "fallout" experience which incorporates such factors as changes in market rates, origination channels and loan purpose.

The following table presents additional information about assets measured at fair value on a recurring basis for which the Company has utilized Level 3 inputs to determine fair value:

	Forward loan sales (in thousands)
Beginning balance, January 1, 2011	\$ 3
Total losses— realized/unrealized:	

Included in earnings	(24 )
Included in other comprehensive income	-
Purchases, issuances, and settlements	-
Ending balance, September 30, 2011	\$ (21 )

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Assets measured at fair value on a nonrecurring basis segregated by fair value hierarchy level are summarized below (in thousands):

At September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2011
(in thousands)				
Assets				
Impaired loans	\$ -	\$ -	\$ 10,585	\$ 10,585
Real estate acquired through foreclosure	-	-	8,909	8,909
Mortgage servicing rights	-	718	-	718

At December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2010
(in thousands)				
Assets				
Impaired loans	\$ -	\$ -	\$ 11,375	\$ 11,375
Real estate acquired through foreclosure	-	-	7,482	7,482
Mortgage servicing rights	-	878	-	878

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of the recorded investment in the loan or fair value. Real estate acquired through foreclosure is initially valued at the lower of the recorded investment in the loan or fair value at foreclosure less costs to sell and subsequently adjusted for further decreases in market value, if necessary. Fair value is determined by using the value of the collateral securing the loans and is therefore classified as a Level 3 hierarchy. The value of the real estate securing impaired loans and real estate acquired through foreclosure is based on appraisals prepared by qualified independent licensed appraisers contracted by the Company to perform the assessment.

The Company initially recognizes and measures servicing assets based on the fair value of the servicing right at the time the loan is sold. The Company uses the amortized cost method for subsequent measurement of its servicing assets and evaluates the recorded value for impairment quarterly. The Company retains a qualified valuation service to calculate the amortized cost and to determine the fair value of the mortgage servicing rights. The valuation service utilizes discounted cash flow analyses adjusted for prepayment speeds, market discount rates and conditions existing in the secondary servicing market. Hence, the fair value of mortgage servicing rights is deemed a Level 2 hierarchy. The amortized cost basis of the Company's mortgage servicing rights was \$954,000 and \$997,000 at September 30, 2011 and December 31, 2010, respectively. The fair value of the mortgage servicing rights was \$718,000 and \$878,000 at September 30, 2011 and December 31, 2010, respectively and was included in other assets in the

consolidated balance sheets.



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## NOTE 9- FAIR VALUE OF FINANCIAL INSTRUMENTS

For the Bank, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments. However, many such instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Also, it is the Company's general practice and intent to hold its financial instruments to maturity or available for sale and to not engage in trading or significant sales activities. For fair value disclosure purposes, the Company substantially utilized the fair value measurement criteria as explained in Note 8- Fair Value Measurements. Additionally, the Company used significant estimations and present value calculations to prepare this disclosure.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. In addition, there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

Fair values have been estimated using data which management considered the best available, as generally provided by estimation methodologies deemed suitable for the pertinent category of financial instrument. The estimation methodologies, resulting fair values and recorded carrying amounts are as follows:

The fair value of cash and cash equivalents equals historical book value. The fair value of investment securities is described and presented under fair value measurement guidelines as amended.

	September 30, 2011		December 31, 2010	
	Fair value	Carrying value	Fair value	Carrying value
	(in thousands)			
Cash and cash equivalents	\$14,475	\$14,475	\$7,437	\$7,437
Investment securities	120,818	120,483	127,831	127,490

The fair value of the loans receivable, net has been estimated using the present value of cash flows, discounted at the approximate current market rates, and giving consideration to estimated prepayment risk but not adjusted for credit risk. Loans receivable, net also include loans receivable held for sale.

	September 30, 2011		December 31, 2010	
	Fair value	Carrying value	Fair value	Carrying value
	(in thousands)			
Loans receivable, net	\$538,052	\$505,732	\$518,324	\$501,658

The fair value of deposits and borrowings with stated maturities has been estimated using the present value of cash flows, discounted at rates approximating current market rates for similar liabilities. Fair value of deposits and borrowings with floating interest rates is generally presumed to approximate the recorded carrying amounts.

	September 30, 2011		December 31, 2010	
	Fair value	Carrying value	Fair value	Carrying value
	(in thousands)			
Liabilities				

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Deposits with stated maturities	\$188,033	\$185,460	\$206,791	\$204,159
Borrowings with stated maturities	60,939	59,500	63,811	61,987

The fair value of deposits and borrowings with no stated maturities is generally presumed to approximate the carrying amount (the amount payable on demand). The fair value of deposits and borrowings with floating interest rates is generally presumed to approximate the recorded carrying amount.

	September 30, 2011		December 31, 2010	
	Fair value	Carrying value	Fair value	Carrying value
	(in thousands)			
Deposits with no stated maturities	\$366,218	\$366,218	\$345,976	\$345,976

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The Bank's remaining assets and liabilities are not considered financial instruments. No disclosure of the relationship value of the Bank's deposits is required.

## NOTE 10- SHARE-BASED COMPENSATION

The Company has stock benefit plans that allow the Company to grant options and restricted stock to employees and directors. The awards, which have a term of up to 10 years when issued, vest over a three to five year period. The exercise price of each award equals the market price of the Company's stock on the date of the grant. At September 30, 2011, there was \$56,000 of total unrecognized compensation cost, net of estimated forfeitures, related to non-vested awards under the Company stock option plan. That cost is expected to be recognized over a weighted average period of 12.7 months. Option activity under the Company's stock option plan as of September 30, 2011 was as follows:

			2011	
	Number of	Weighted	Weighted	Aggregate
	shares	average	average	intrinsic
		exercise	remaining	value
		price per	contractual	(\$000)
		share	term (in	
			years)	
Outstanding at January 1, 2011	126,257	\$24.04		
Options granted	-	-		
Options exercised	-	-		
Options forfeited	-	-		
Options expired	2,100	25.71		
Outstanding at September 30, 2011	124,157	\$24.01	2.59	\$-
Options exercisable at September 30, 2011	97,263	\$25.19	2.19	\$-

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading day of the third quarter and the exercise price, multiplied by the number of in-the-money options).

The aggregate intrinsic value and cash receipts of options exercised are as follows:

	September 30,	
	2011	2010
	(in thousands)	
Options Exercised		
Aggregate intrinsic value of options exercised	\$-	\$76
Cash receipts from options exercised	-	177

In July of 2011, the Company issued stock of the Company as payment for director fees as permitted by the 2011 Director Stock Compensation Plan and is included as a component of share-based compensation. The following tables provide information regarding the Company's share-based compensation expense for the three months ended:

	September 30,	
	2011	2010
	(in thousands)	
Share-based compensation expense		
Director fees	\$34	\$-
Stock grant expense	3	4
Stock option expense	8	13
Employee Stock Ownership Plan ("ESOP") expense	53	51
Total share-based compensation expense	\$98	\$68

The Bank reports ESOP expense in an amount equal to the fair value of shares released from the ESOP to employees less dividends received on the allocated shares in the plan used for debt service. Dividends on allocated shares used to reduce ESOP expense totaled \$9,000 and \$11,000 for the three months ended September 30, 2011 and 2010, respectively. Share-based compensation expense related to stock options resulted in a tax benefit of \$2,000 and \$5,000 for the three months ended September 30, 2011 and 2010, respectively.

The following tables provide information regarding the Company's share-based compensation expense for the nine months ended:

	September 30,	
	2011	2010
	(in thousands)	
Share-based compensation expense		
Director fees	\$34	\$-
Stock grant expense	9	12
Stock option expense	24	39
Employee Stock Ownership Plan ("ESOP") expense	168	145
Total share-based compensation expense	\$235	\$196

The Bank reports ESOP expense in an amount equal to the fair value of shares released from the ESOP to employees less dividends received on the allocated shares in the plan used for debt service. Dividends on allocated shares used to reduce ESOP expense totaled \$27,000 and \$33,000 for the nine months ended September 30, 2011 and 2010, respectively.

Share-based compensation expense related to stock options resulted in a tax benefit of \$9,000 and \$13,000 for the nine months ended September 30, 2011 and 2010, respectively.

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## NOTE 11- EMPLOYEE BENEFIT PLANS

Net periodic defined benefit pension cost included the following (in thousands):

	Three months ended September 30, 2011          2010 (in thousands)	
Components of net periodic benefit cost		
Service cost	\$141	\$138
Interest cost	82	74
Expected return on plan assets	(156 )	(141 )
Recognized net actuarial loss	30	42
Net periodic benefit cost	\$97	\$113

	Nine months ended September 30, 2011          2010 (in thousands)	
Components of net periodic benefit cost		
Service cost	\$424	\$415
Interest cost	246	222
Expected return on plan assets	(466 )	(414 )
Recognized net actuarial loss	88	117
Net periodic benefit cost	\$292	\$340

There was no employer contribution for the nine months ended September 30, 2011 and 2010.

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## NOTE 12 — ACCOUNTING STANDARDS UPDATE

In April 2011, the Financial Accounting Standards Board (“FASB”) issued an amendment to provide additional guidance or clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments are effective for the first interim or annual reporting period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company has adopted the guidance and has included the required disclosures in Note 7-Loans Receivable.

In April 2011, the FASB issued an accounting update to improve the accounting for repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendments apply to all entities, both public and nonpublic. The amendments affect all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The guidance is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. This amendment is not expected to have a significant impact on the Company’s financial statements or results of operations.

In May 2011, the FASB issued, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (“IFRSs”). The amendments result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. This amendment is not expected to have a significant impact on the Company’s financial statements or results of operations.

In June 2011, the FASB issued, “Presentation of Comprehensive Income”. The amendments improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity was eliminated. The amendments require that all non-owner changes in stockholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The amendments should be applied retrospectively, and early adoption is permitted. This amendment is not expected to have a significant impact on the Company’s financial statements or results of operations.

In September 2011, the FASB issued an accounting update, “Intangibles – Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment”. The objective of this update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity’s financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. This accounting update is not expected to have a significant impact on the Company’s financial statements.

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TF FINANCIAL CORPORATION AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

GENERAL

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 Quarterly Report on Form 10-Q and the exhibits thereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995.

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

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

Financial Position

The Company's total assets at September 30, 2011 and December 31, 2010 were \$695.2 million and \$691.8 million, respectively, representing an increase of \$3.4 million during the nine-month period. Loans receivable, net increased by \$2.5 million during the first nine months of 2011. Originations of consumer and single-family residential mortgage loans totaling \$49.4 million and commercial loans totaling \$26.6 million were offset by principal repayments of \$68.1 million. The Company increased the allowance for loan losses by \$2.9 million and transferred \$2.4 million from loans to real estate acquired through foreclosure. Loans receivable held for sale increased \$1.6 million as originations of loans for sale in the secondary market of \$17.2 million were offset by of proceeds of \$15.7 million from loan sales. Investment securities decreased by \$7.0 million due to principal repayments received of \$21.5 million, security sales of \$4.8 million, security maturities of \$3.9 million and net premium amortization of \$200,000 that were offset by security purchases of \$20.7 million and increases in the fair value of available for sale securities of \$2.7 million. As a result of the Company's cash-related activities, cash and cash equivalents increased by \$7.0 million during the first nine months of 2011. The increase in other assets was caused by a foreclosure action against a single borrower that resulted in the acquisition of 35 residential properties totaling \$1.4 million. At September 30, 2011, real estate



acquired through foreclosure totaled \$8.9 million and was comprised of one parcel of unimproved raw land, a commercial property and 40 residential properties.

Total liabilities decreased by \$0.7 million during the first nine months of 2011. Advances from the Federal Home Loan Bank decreased by \$2.5 million, the result of scheduled amortization and maturities of \$20.0 million offset by the proceeds of long term advances of \$6.6 million and short term borrowings of \$10.9 million. Deposit balances increased \$1.5 million during the period with checking, money market and savings accounts increasing by \$20.2 million while retail certificates of deposit decreased \$18.7 million.

Total consolidated stockholders' equity of the Company was \$77.5 million or 11.2% of total assets at September 30, 2011. At September 30, 2011, there were approximately 102,000 shares available for repurchase under the previously announced share repurchase plan.

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## Asset Quality

Non-performing assets include real estate owned which is carried at estimated fair value and non-performing loans. Non-performing loans include impaired loans and loan balances 90 days or more past due for which the accrual of interest has been discontinued. The following table sets forth information regarding the Company's non performing assets:

Non-Performing Assets	September 30, 2011	December 31, 2010	September 30, 2010			
		(in thousands)				
Mortgage secured by:						
One-to four- family residences	\$5,144	\$ 3,618	\$1,470			
Non-residential properties or non—owner occupied residential properties	1,214	4,993	4,239			
Construction loans	5,707	4,307	4,241			
Commercial-business, real estate secured	4,601	4,601	10,467			
Commercial-business, non-real estate secured	160	44	1,128			
Home equity and second mortgage	277	1,412	-			
Other consumer	-	3	-			
Total non-performing loans	17,103	18,978	21,545			
Real estate owned	8,909	7,482	2,153			
Total non-performing assets	\$26,012	\$ 26,460	\$23,698			
Total loans 90 days or more past due as to interest or principal and accruing interest	\$-	\$ -	\$-			
Ratio of non-performing loans to gross loans	3.32	%	3.72	%	4.08	%
Ratio of non-performing loans to total assets	2.46	%	2.74	%	3.07	%
Ratio of total non-performing assets to total assets	3.74	%	3.83	%	3.37	%

Non-performing loans secured by one-to four-family residential properties include a loan with a balance of \$1.9 million secured by a residential property. The borrower has listed the property for sale and will apply the proceeds toward the outstanding loan balance. A recent appraisal indicates a fair value in excess of the recorded investment in the loan. The Bank has initiated foreclosure proceedings. In addition, this category also includes a loan with a balance of \$1.3 million for which the Bank has allocated \$217,000 of the allowance for loan losses to this loan, equal to the difference between the loan balance and the fair value less estimated selling costs.

Non-performing construction loans include a loan with a balance of \$2.4 million, secured by a largely completed commercial office building, and the personal guarantee of the borrowers. The Bank has allocated \$1.2 million of the allowance for loan losses to this loan, equal to the difference between the loan balance plus other acquisition costs and the fair value based upon a recent appraisal less estimated costs to sell. On October 19, 2011, the Bank acquired the property through foreclosure and is in the process of listing the property for sale. The charge to the allowance is anticipated to approximate the amount that the Bank has allocated to this loan.

Also included in construction loans is a loan with a balance of \$1.5 million secured by two contiguous parcels of commercial real estate and a lien on the guarantor's personal residence. The Bank has allocated to this loan \$0.9 million of the allowance for loan losses, equal to the difference between the loan balance plus other acquisition costs and the fair value based upon a recent appraisal less estimated costs to sell. The Bank has initiated foreclosure proceedings and the borrower has filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code.

Construction loans also include a loan with a balance of \$1.8 million secured by five contiguous lots approved for construction of commercial and residential buildings. The Bank allocated \$0.7 million of the allowance for loan losses equal to the difference between the loan balance and a recent appraisal. The borrower is attempting to sell the properties and apply the proceeds towards the outstanding loan balance.

Commercial-business loans secured by real estate include a loan with a balance of \$2.6 million secured by a parcel of vacant land approved for townhome development. The Bank has allocated \$0.9 million of the allowance for loan losses to the loan, equal to the difference between the loan balance plus other acquisition costs and the fair value based upon a recent appraisal less estimated costs to sell. On November 1, 2011 the Bank acquired the property through foreclosure and is in the process of listing the property for sale.

Commercial-business, real estate secured loans also include two loans, with a combined balance of \$2.0 million secured by a parcel of land. The borrower is attempting to sell the property and intends to apply the sale proceeds to the outstanding loan balance. A recent appraisal of the property indicates that the appraised value less selling cost is in excess of the loan balances.

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

Foreclosed property at September 30, 2011 included 42 parcels of real estate with a combined carrying value of \$8.9 million. During the second quarter of 2011, the Bank completed foreclosure proceedings on 4 loans that were secured by 35 residential rental properties located in the greater Philadelphia area. Subsequent to foreclosure the Bank was able to gain access to the properties to ascertain physical inspection and appraisals of the properties. The recording of the fair value of these properties resulted in a charge to the allowance for loan loss of \$1.0 million. Also during 2011, the Bank foreclosed on a home equity loan secured by a single family dwelling valued at \$0.8 million which resulted in a charge to the allowance of \$0.2 million. During the first nine months of 2011, the Bank sold three single family dwellings acquired through foreclosure with a recorded value of \$0.7 million which approximated the carrying value of the assets. All foreclosed properties are listed or are in the process of being listed with real estate agents for sale in a timely manner. Foreclosed real estate is included in other assets in the consolidated balance sheet.

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Allowance for Loan Losses

The Bank provides valuation allowances for estimated losses from uncollectible loans. The allowance is increased by provisions charged to expense and reduced by net charge-offs. On a quarterly basis, the Company prepares an allowance for loan losses (ALLL) analysis. In the analysis, the loan portfolio is segmented into groups of homogeneous loans that share similar risk characteristics: non-residential or non-owner occupied residential real estate, commercial construction, commercial business, single family residential, and consumer which is predominately real estate secured junior liens and home equity lines of credit. Each segment is assigned reserve factors based on quantitative and qualitative measurements. In addition, the Bank reviews its internally classified loans, its loans classified for regulatory purposes, delinquent loans, and other relevant information in order to isolate loans for further scrutiny as potentially impaired loans.

Quantitative factors include an actual expected loss factor based on historical loss experience over a relevant look-back period. Quantitative factors also include the Bank's actual risk ratings for the commercial loan segments as determined in accordance with loan review and loan grading policies and procedures, and additional factors as determined by management to be representative of additional risk due to the loan's geographic location, type, and other attributes. These quantitative factors are adjusted if necessary, up or down, based on actual experience and an evaluation of the qualitative factors.

Qualitative factors are based upon: (1) changes in lending policies and procedures, including but not limited to changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses; (2) changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments; (3) changes in the nature and volume of the portfolio and in the terms of loans; (4) changes in the experience, ability, and depth of lending management and other relevant staff; (5) changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans; (6) changes in the quality of the loan review system; (7) changes in the value of underlying collateral for collateral dependent loans; (8) the existence and effect of any concentration of credit, and changes in the level of such concentrations; and (9) the effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio.

Potentially impaired loans selected for individual evaluation are reviewed in accordance with US GAAP which governs the accounting for impaired assets, and consideration of regulatory guidance regarding treatment of troubled, collateral dependent loans. Each potentially impaired loan is evaluated using all available information such as recent appraisals, whether the loan is currently on accrual or non-accrual status, discounted cash flow analyses, guarantor financial strength, the value of additional collateral, and the loan's and borrower's past performance to determine whether in management's best judgment it is probable that the Bank will be unable to collect all contractual interest and principal in accordance with the loan's terms. Loans deemed impaired are generally assigned a reserve derived from the value of the underlying collateral. Loans deemed not to be impaired are assigned a reserve factor based upon the segment from which they were selected.

The ALLL needed as a result of the foregoing evaluations is compared with the unadjusted amount, and an adjustment is made by means of a provision charged to expense for loan losses. Recognizing the inherently imprecise nature of the loss estimates and the large number of assumptions needed in order to perform the analysis, the required reserve may be less than the actual level of reserves at the end of any evaluation period, and thus there may be an unallocated portion of the ALLL. Management adjusts the unallocated portion to an amount which management considers reasonable under the circumstances.



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## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

Net Income. The Company recorded net income of \$1.1 million, or \$0.40 per diluted share, for the three months ended September 30, 2011 as compared to net income of \$1.0 million, or \$0.38 per diluted share, for the three months ended September 30, 2010.

## Average Balance Sheet

The following table sets forth information (dollars in thousands) relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Yield and cost are computed by dividing income or expense by the average daily balance of interest-earning assets or interest-bearing liabilities, respectively, for the three-month periods indicated.

	Three Months Ended September 30,						Average yld/cost	
	Average balance	2011 Interest	Average yld/cost		Average balance	2010 Interest		
<b>ASSETS</b>								
Interest-earning assets:								
Loans receivable(1)	\$502,574	\$6,667	5.26	%	\$522,181	\$7,020	5.33	%
Mortgage-backed securities	66,283	702	4.20	%	79,070	886	4.45	%
Investment securities(2)	67,662	705	4.13	%	59,077	586	3.94	%
Other interest-earning assets(3)	3,237	-	* 0.00	%	10,122	-	* 0.00	%
Total interest-earning assets	639,756	8,074	5.01	%	670,450	8,492	5.03	%
Non interest-earning assets	53,907				42,716			
Total assets	\$693,663				\$713,166			
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>								
Interest-bearing liabilities:								
Deposits	\$555,713	1,430	1.02	%	\$556,314	1,757	1.25	%
Borrowings from the FHLB	54,709	473	3.43	%	75,130	731	3.86	%
Total interest-bearing liabilities	610,422	1,903	1.24	%	631,444	2,488	1.56	%
Non interest-bearing liabilities	7,075				7,744			
Total liabilities	617,497				639,188			
Stockholders' equity	76,166				73,978			
Total liabilities and stockholders' equity	\$693,663				\$713,166			
Net interest income—tax equivalent basis								
		6,171				6,004		
Interest rate spread(4)-tax equivalent basis								
			3.77	%			3.47	%
Net yield on interest-earning assets(5) —tax equivalent basis								
			3.83	%			3.55	%
Ratio of average interest-earning assets to average interest-bearing liabilities								
			104.81	%			106.18	%
Less: tax—equivalent interest adjustments								
		(166)				(142)		
Net interest income								
		\$6,005				\$5,862		
Interest rate spread(4)								
			3.67	%			3.38	%

Net yield on interest-earning assets(5)	3.72	%	3.47	%
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- (1) Non-performing loans have been included in the appropriate average loan balance category, but interest on non-performing loans has not been included for purposes of determining interest income.
- (2) Tax equivalent adjustments to interest on investment securities were \$166,000 and \$142,000 for the quarter ended September 30, 2011 and 2010, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.
- (3) Includes interest-bearing deposits in other banks.
- (4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.  
Net yield on interest-earning assets represents net interest income as a percentage of average interest-earning assets.

\* Is less than \$500 for period indicated

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## Rate/Volume Analysis

The following table presents, for the periods indicated, the change in interest income and interest expense (in thousands) attributed to (i) changes in volume (changes in the weighted average balance of the total interest earning asset and interest bearing liability portfolios multiplied by the prior year rate), and (ii) changes in rate (changes in rate multiplied by prior year volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately based on the absolute value of changes due to volume and changes due to rate.

	Three months ended September 30 2011 vs 2010		
	Volume	Rate	Net
Interest income:			
Loans receivable, net	\$(261 )	\$(92 )	\$(353 )
Mortgage-backed securities	(137 )	(47 )	(184 )
Investment securities (1)	88	31	119
Other interest-earning assets	-	-	-
Total interest-earning assets	(310 )	(108 )	(418 )
Interest expense:			
Deposits	(2 )	(325 )	(327 )
Borrowings from the FHLB	(183 )	(75 )	(258 )
Total interest-bearing liabilities	(185 )	(400 )	(585 )
Net change in net interest income	\$(125 )	\$292	\$167

- (1) Tax equivalent adjustments to interest on investment securities were \$166,000 and \$142,000 for the quarters ended September 30, 2011 and 2010, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

**Total Interest Income.** Total interest income, on a taxable equivalent basis, decreased by \$418,000 or 4.9% to \$8.1 million for the quarter ended September 30, 2011 compared with the third quarter of 2010. Interest income from loans receivable decreased by \$353,000, the result of a \$19.6 million decrease in the average balance of loans outstanding plus a decrease in the average yield on loans of 7 basis points. The decrease in the yield was caused by the effect of new loans added to the portfolio with a lower yield than the existing portfolio loans that matured or refinanced. Interest income from mortgage-backed securities was lower in the quarter in comparison to the same period of 2010 mainly because principal repayments and sales of \$31.0 million exceeded purchases of \$19.6 million during the intervening period. Additionally, the yield associated with repayments was higher than the yield on newly purchased mortgage-backed securities. Interest income from investment securities was higher as purchases of \$13.3 million of investments exceeded sales and maturities of investment securities totaling \$7.5 million during the intervening period.

**Total Interest Expense.** Total interest expense decreased by \$585,000 to \$1.9 million during the three-month period ended September 30, 2011 as compared with the corresponding quarter of 2010. The average interest rates paid on the Bank's deposits were 23 basis points lower in 2011 due to the maturity of certificates of deposit with higher interest rates than current market rates offered on the products into which the maturing CDs were renewed or reinvested. Interest expense associated with borrowings from the Federal Home Loan Bank decreased \$258,000 between the third quarter of 2011 and 2010. During the intervening period, the Bank reduced its average outstanding borrowings by \$20.4 million including the maturity of higher rate advances, thus the cost of funds of the remaining outstanding advances was 43 basis points lower.





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Non-interest income. Total non-interest income was \$329,000 for the third quarter of 2011 compared with \$927,000 for the same period in 2010. Net losses resulting from valuation adjustments and disposition of real estate acquired through foreclosure totaled \$254,000 while there were no such losses in the third quarter of 2010. Gain on the sale of loans in the secondary market was \$228,000 lower in the third quarter of 2011 when compared to the same quarter of 2010. Service fees and other charges decreased \$106,000 between the quarters. Fair value adjustments to mortgage servicing rights reduced loan servicing income between the quarters by \$121,000.

Non-interest expense. Total non-interest expense increased by \$185,000 to \$4.4 million for the three months ended September 30, 2011 compared to the same period in 2010. Employee compensation and benefits increased \$315,000 mainly because various bonus and incentive compensation programs for 2010 were suspended in the third quarter of 2010 resulting in a reversal of \$235,000 of compensation previously expensed through June 30, 2010. During 2011, such plans have not been suspended and \$121,000 for these plans was included in compensation and benefits expense during the third quarter of 2011. Professional fees increased \$67,000 between the two periods due to increased legal costs associated with non-performing loans and foreclosures of \$33,000 and professional services associated with the holding company consultants of \$32,000. Other operating expense increased \$33,000 as a result of increased costs of \$52,000 associated with maintenance of real estate acquired through foreclosure. FDIC insurance premiums decreased by \$91,000 between the two quarters due to a change in the method of premium assessment. Prior to the second quarter, premium assessment was based solely on deposit balances whereas beginning in the second quarter of 2011 under the new rules, the deposit insurance assessment base will be a bank's average total assets less its average tangible equity, with adjustments for brokered deposits and unsecured debt. Office and occupancy costs decreased \$75,000 in part due to the relocation of retail support services from a rented facility to a bank owned office. Marketing and advertising expenses decreased \$64,000 between the two quarters as marketing-related activities were streamlined during the period.

Income tax expense. The Company's effective tax rate was 22.5% for the quarter ended September 30, 2011 compared to 27.0% for the quarter ended September 30, 2010. These effective tax rates are lower than the Company's marginal tax rate of 34% largely due to the tax-exempt income associated with the Company's investments in tax-exempt municipal bonds and bank-owned life insurance.

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## RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010

Net Income. The Company recorded net income of \$2.4 million, or \$0.89 per diluted share, for the nine months ended September 30, 2011 as compared to net income of \$2.7 million, or \$1.01 per diluted share, for the nine months ended September 30, 2010.

## Average Balance Sheet

The following table sets forth information (dollars in thousands) relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the periods indicated. Yield and cost are computed by dividing income or expense by the average daily balance of interest-earning assets or interest-bearing liabilities, respectively, for the nine-month periods indicated.

	Nine Months Ended September 30,						Average yld/cost	
	Average balance	2011 Interest	Average yld/cost		Average balance	2010 Interest		
<b>ASSETS</b>								
Interest-earning assets:								
Loans receivable(1)	\$501,052	\$19,946	5.32	%	\$524,734	\$21,472	5.47	%
Mortgage-backed securities	65,541	2,068	4.22	%	80,538	2,782	4.62	%
Investment securities(2)	67,714	2,155	4.25	%	56,956	1,709	4.01	%
Other interest-earning assets(3)	4,970	1	0.03	%	10,112	2	0.03	%
Total interest-earning assets	639,277	24,170	5.05	%	672,340	25,965	5.16	%
Non interest-earning assets	49,759				42,050			
Total assets	\$689,036				\$714,390			
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>								
Interest-bearing liabilities:								
Deposits	\$549,364	4,328	1.05	%	\$554,259	5,593	1.35	%
Borrowings from the FHLB	57,688	1,537	3.56	%	78,684	2,372	4.03	%
Total interest-bearing liabilities	607,052	5,865	1.29	%	632,943	7,965	1.68	%
Non interest-bearing liabilities	6,867				8,240			
Total liabilities	613,919				641,183			
Stockholders' equity	75,117				73,207			
Total liabilities and stockholders' equity	\$689,036				\$714,390			
Net interest income—tax equivalent basis		18,305				18,000		
Interest rate spread(4)-tax equivalent basis			3.76	%			3.48	%
Net yield on interest-earning assets(5) —tax equivalent basis			3.83	%			3.58	%
Ratio of average interest-earning assets to average interest-bearing liabilities			105.31	%			106.22	%
Less: tax—equivalent interest adjustments		(495 )				(418 )		
Net interest income		\$17,810				\$17,582		

Interest rate spread(4)	3.66	%	3.40	%
Net yield on interest-earning assets(5)	3.72	%	3.50	%

(1) Non-performing loans have been included in the appropriate average loan balance category, but interest on non-performing loans has not been included for purposes of determining interest income.

(2) Tax equivalent adjustments to interest on investment securities were \$495,000 and \$418,000 for the nine months ended September 30, 2011 and 2010, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

(3) Includes interest-bearing deposits in other banks.

(4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

Net yield on interest-earning assets represents net interest income as a percentage of average

(5) interest-earning assets.

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## Rate/Volume Analysis

The following table presents, for the periods indicated, the change in interest income and interest expense (in thousands) attributed to (i) changes in volume (changes in the weighted average balance of the total interest earning asset and interest bearing liability portfolios multiplied by the prior year rate), and (ii) changes in rate (changes in rate multiplied by prior year volume). Changes attributable to the combined impact of volume and rate have been allocated proportionately based on the absolute value of changes due to volume and changes due to rate.

	Nine months ended September 30 2011 vs 2010		
	Increase (decrease) due to		
	Volume	Rate	Net
Interest income:			
Loans receivable, net	\$(953 )	\$(573 )	\$(1,526 )
Mortgage-backed securities	(487 )	(227 )	(714 )
Investment securities (1)	338	108	446
Other interest-earning assets	(1 )	-	(1 )
Total interest-earning assets	(1,103 )	(692 )	(1,795 )
Interest expense:			
Deposits	(49 )	(1,216 )	(1,265 )
Borrowings from the FHLB	(582 )	(253 )	(835 )
Total interest-bearing liabilities	(631 )	(1,469 )	(2,100 )
Net change in net interest income	\$(472 )	\$777	\$305

- (1) Tax equivalent adjustments to interest on investment securities were \$495,000 and \$418,000 for the nine months ended September 30, 2011 and 2010, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

**Total Interest Income.** Total interest income, on a taxable equivalent basis, decreased by \$1.8 million or 6.9% to \$24.2 million for the nine months ended September 30, 2011 compared with the first nine months of 2010. Interest income from loans receivable decreased by \$1.5 million, the result of a \$23.7 million decrease in the average balance of loans outstanding plus a decrease in the average yield on loans of 15 basis points. The decrease in the yield was caused by an increase in non-performing loans between the periods which reduced interest income from loans by \$253,000. Also, new loans added to the portfolio during the period have a lower yield than the existing portfolio loans that matured or refinanced. Interest income from mortgage-backed securities was lower in 2011 in comparison to the same period of 2010 mainly because principal repayments and sales of \$21.1 million exceeded purchases of \$19.6 million during the intervening period. Additionally, the yield associated with repayments was higher than the yield on newly purchased mortgage-backed securities. Interest income from investment securities was higher as a result of purchases of \$13.3 million of higher yielding investments that exceeded sales and maturities of \$7.5 million during the intervening period resulting in an increase in the yield of 24 basis points.

**Total Interest Expense.** Total interest expense decreased by \$2.1 million to \$5.9 million during the nine-month period ended September 30, 2011 as compared with the same period in 2010. The average interest rates paid on the Bank's deposits were 30 basis points lower in 2011 due to the maturity of certificates of deposit with higher interest rates than current market rates offered on the products into which the maturing CDs were renewed or reinvested. Interest

expense associated with borrowings from the Federal Home Loan Bank decreased \$835,000 between 2010 and 2011. During the intervening period, the Bank reduced its average outstanding borrowings by \$21.0 million, including the maturity of higher rate advances, thus the cost of funds of the remaining outstanding advances was 47 basis points lower.

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Non-interest income. Total non-interest income was \$2.0 million for the first nine months of 2011 compared with \$2.1 million for the same period in 2010. Gain on the sale of loans in the secondary market was \$173,000 lower in 2011 when compared to the same period of 2010. Net losses resulting from valuation adjustments and disposition of real estate acquired through foreclosure were \$117,000 greater in 2011 versus 2010. Offsetting these decreases was a gain on the sale of investment securities which was \$203,000 higher in 2011.

Non-interest expense. Total non-interest expense increased by \$588,000 to \$14.0 million for the nine months ended September 30, 2011 compared to the same period in 2010. Employee compensation and benefits increased \$316,000 mainly because various bonus and incentive compensation programs for 2010 were suspended in the third quarter of 2010 resulting in a reversal of \$235,000 of compensation previously expensed through June 30, 2010. During 2011, such plans have not been suspended and \$239,000 for these plans was included in compensation and benefits expense during 2011. Professional fees increased \$385,000 between the two periods as legal costs associated with non-performing loans and foreclosures increased \$182,000. Additionally, legal and professional costs were incurred in connection with the Company's reincorporation in Pennsylvania, the cost of distributing a 5% stock dividend in the first quarter of 2011 and the implementation of the director's stock compensation plan. Other operating expense increased \$185,000 mainly because of increased appraisal costs associated with nonperforming loans and costs to maintain and liquidate real estate acquired through foreclosure. In contrast, FDIC insurance premiums decreased by \$160,000 between the two periods due to change in the method of premium assessment. Prior to the second quarter of 2011, premium assessment was based solely on deposit balances whereas beginning in the second quarter of 2011 under the new rules, the deposit insurance assessment base will be a bank's average total assets less its average tangible equity, with adjustments for brokered deposits and unsecured debt. Also, marketing and advertising expenses decreased \$135,000 between the two periods as marketing-related activities were streamlined during the period.

Income tax expense. The Company's effective tax rate was 17.5% for the nine months ended September 30, 2011 compared to 24.6% for the nine months ended September 30, 2010. These effective tax rates are lower than the Company's marginal tax rate of 34% largely due to the tax-exempt income associated with the Company's investments in tax-exempt municipal bonds and bank-owned life insurance.

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LIQUIDITY AND CAPITAL RESOURCES

Liquidity

The Bank's liquidity is a measure of its ability to fund loans, pay withdrawals of deposits, and other cash outflows in an efficient, cost-effective manner. The Bank's short-term sources of liquidity include maturities, repayment and sales of assets, excess cash and cash equivalents, new deposits, broker deposits, other borrowings, and new borrowings from the Federal Home Loan Bank and the Federal Reserve Bank. There has been no material adverse change during the three-month period ended September 30, 2011 in the ability of the Bank and its subsidiaries to fund their operations.

At September 30, 2011, the Bank had commitments outstanding under letters of credit of \$0.7 million, commitments to originate loans of \$15.1 million, and commitments to fund undisbursed balances of closed loans and unused lines of credit of \$49.2 million. At September 30, 2011, the Bank had \$6.0 million in outstanding commitments to sell loans. There has been no material change during the three months ended September 30, 2011 in any of the Bank's other contractual obligations or commitments to make future payments.

The Company's primary sources of liquidity are dividends from the Bank, principal and interest payments received from a loan made to the Bank's Employee Stock Ownership Plan, and tax benefits arising from the use of the Company's tax deductions by other members of its consolidated group pursuant to a tax sharing agreement. The Company is dependent upon these sources and cash on hand which totaled approximately \$1.5 million at September 30, 2011 in order to fund its operations and pay the dividend to its shareholders. There has been no material adverse change in the ability of the Company to fund its operations during the three-month period ended September 30, 2011.

Capital Requirements

The Bank was in compliance with all of its capital requirements as of September 30, 2011.

CRITICAL ACCOUNTING POLICIES

Certain critical accounting policies of the Company require the use of significant judgment and accounting estimates in the preparation of the consolidated financial statements and related data of the Company. These accounting estimates require management to make assumptions about matters that are highly uncertain at the time the accounting estimate is made. Management believes that the most critical accounting policy requiring the use of accounting estimates and judgment is the determination of the allowance for loan losses. If the financial position of a significant amount of debtors or the value of the collateral securing the loans should deteriorate more than the Company has estimated, the present allowance for loan losses may be insufficient and additional provisions for loan losses may be required. The allowance for loan losses was approximately \$9.6 million at September 30, 2011.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a "smaller reporting company" as defined by Item 10 of Regulation S-K, the Company is not required to provide the information required by this item.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures



Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")), the Company's principal executive officer and principal financial officer have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files and submits pursuant to the rules and forms of the SEC is accumulated and communicated to the Company's management including the principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

#### Changes in Internal Controls over Financial Reporting

During the quarter under report, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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TF FINANCIAL CORPORATION AND SUBSIDIARIES

PART II

ITEM 1. LEGAL PROCEEDINGS

Neither the Company nor its subsidiaries are involved in any pending legal proceedings, other than routine legal matters occurring in the ordinary course of business that in the aggregate involve amounts which are believed by management to be immaterial to the consolidated financial condition or results of operations of the Company.

ITEM 1A. RISK FACTORS

As a “smaller reporting company” as defined by Item 10 of Regulation S-K, the Company is not required to provide the information required by this item.

ITEM 2. UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. [REMOVED AND RESERVED]

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a)	Exhibits	
	31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
	31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
	32.	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
	101.INS	XBRL Instance Document
	101.SCH	XBRL Taxonomy Extension Schema Document
	101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
	101.LAB	XBRL Taxonomy Extension Label Linkbase Document
	101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document



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TF FINANCIAL CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 14, 2011

/s/ Kent C. Lufkin  
Kent C. Lufkin  
President and CEO  
(Principal Executive Officer)

Date: November 14, 2011

/s/ Dennis R. Stewart  
Dennis R. Stewart  
Executive Vice President and Chief  
Financial Officer  
(Principal Financial & Accounting Officer)

