Cullman Bancorp, Inc.
Form 10-K
March 18, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year ended December 31, 2010

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 000-53801

Cullman Bancorp, Inc.

(Exact Name of Registrant as Specified in Charter)

Federal	**63-0052835**
(State of Other Jurisdiction	**(I.R.S Employer**
of Incorporation)	**Identification Number)**
316 Second Avenue S.W., Cullman, Alabama	**35055**
(Address of Principal Executive Officer)	**(Zip Code)**

256-734-1740

Registrant s telephone number, including area code

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

None

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

Common Stock, par value $.01 per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

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

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of March 18, 2011, there were issued and outstanding 2,512,750 shares of the Registrant s Common Stock, par value $.01 per share.

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, computed by reference to the last sales price on June 30, 2010 was $11.4 million.

Documents incorporated by reference:

Proxy statement for 2010 Annual Meeting of Shareholders of the Registrant (Part III).

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PART I

Item 1. Business

Forward Looking Statements

This Annual Report (including information incorporated by reference) contains, and future oral and written statements of Cullman Bancorp, Inc. (Cullman Bancorp or the Company) and its management may contain, forward-looking statements as such term is defined in the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of Cullman Bancorp. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of Cullman Bancorp s management and on information currently available to management, are generally identifiable by the use of words such as believe, expect, anticipate, plan, intend, estimate, may, will, would, could, should or other similar expressions. Additionally, all staten document, including forward-looking statements, speak only as of the date they are made, and Cullman Bancorp undertakes no obligation to update any statement in light of new information or future events. By identifying these forward-looking statements for you in this manner, we are alerting you to the possibility that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in these forward-looking statements. Important factors which could cause our actual results and financial condition to differ from those indicated in the forward looking statements include those set forth in Item 2 of our most recent Quarterly Report on Form 10-Q. These risks and uncertainties should be considered in evaluating forward looking statements and undue reliance should not be placed on such statements.

Cullman Savings Bank, MHC

Cullman Savings Bank, MHC is our federally-chartered mutual holding company parent. As a mutual holding company, Cullman Savings Bank, MHC is a non-stock company. As of December 31, 2010, Cullman Savings Bank, MHC owned 55% of Cullman Bancorp s common stock. As long as Cullman Savings Bank, MHC exists, it is required to own a majority of the voting stock of Cullman Bancorp and, through its board of directors, will be able to exercise voting control over most matters put to a vote of shareholders. Cullman Savings Bank, MHC does not engage in any business activity other than owning a majority of the common stock of Cullman Bancorp.

Cullman Bancorp, Inc.

Cullman Bancorp, Inc. is the federally-chartered mid-tier stock holding company formed by Cullman Savings Bank to be its holding company as part of its mutual holding company reorganization and initial public offering. Cullman Bancorp owns all of Cullman Savings Bank s capital stock. Cullman Bancorp s primary business activities, apart from owning the shares of Cullman Savings Bank, currently consist of loaning funds to the Cullman Savings Bank s Employee Stock Ownership Plan (ESOP) and investing in checking and money market accounts at Cullman Savings Bank. For parent only financial statements, see Note 17 of the Notes to Consolidated Financial Statements.

Cullman Bancorp, as the holding company of Cullman Savings Bank, is authorized to pursue other business activities permitted by applicable laws and regulations, which may include the acquisition of banking and financial services companies. See Supervision and Regulation Holding Company Regulation for a discussion of the activities that are permitted for savings and loan holding companies. We currently have no specific arrangements or understandings regarding any such other activities.

Our cash flow will depend on earnings from the investment of the net proceeds we retain, and any dividends received from Cullman Savings Bank. Cullman Bancorp, Inc. currently neither owns nor leases any property, but instead uses the premises, equipment and furniture of Cullman Savings Bank. At the present time, we employ only persons who are officers of Cullman Savings Bank to serve as officers of Cullman Bancorp. However, we use the support staff of Cullman Savings Bank from time to time. These persons will not be separately compensated by Cullman Bancorp. Cullman Bancorp may hire additional employees, as appropriate, to the extent it expands its business in the future.

Cullman Savings Bank

Our principal business consists of attracting retail deposits from the general public in our market and investing those deposits, together with funds generated from operations and, to a lesser extent, borrowings in one-to-four family residential mortgage loans and commercial real estate loans, and, to a lesser extent, multi-family mortgage loans, construction loans, land loans, home equity loans, commercial loans and consumer loans. We also invest in U.S. Government and federal agency securities, mortgage-backed securities and, to a lesser extent, mutual funds that invest in those securities. Our revenues are derived principally from the interest on loans and securities, loan origination and servicing fees and fees levied on deposit accounts. Our primary sources of funds are principal and interest payments on loans and securities, deposits and advances from the Federal Home Loan Bank of Atlanta.

In 1999, we amended our business plan to increase significantly our commercial real estate lending in order to enhance the yield and interest rate sensitivity of our loan portfolio. In 2006, we appointed a new President and Chief Executive Officer from within our organization and hired a new Executive Vice President in charge of lending, both of whom have significant commercial lending experience. In the years since these management changes, our portfolio of commercial real estate loans has increased significantly. We expect this portfolio to continue to increase in the future, but at a more measured pace.

Reflecting our focus on our community, in 2002 we formed Cullman Savings Foundation, a private foundation. In connection with the stock offering, we formed another charitable foundation called Cullman Savings Bank Charitable Foundation. It was funded with 50,255 shares of common stock of Cullman Bancorp and $100,000 in cash. We formed a new foundation rather than making this contribution to Cullman Savings Foundation based on certain Internal Revenue Service regulations that may limit our ability to make a contribution of Cullman Bancorp common stock to an existing foundation. The corporate purpose of this new foundation is substantially the same as Cullman Savings Foundation.

Our website address is www.cullmansavingsbank.com. Information on our website should not be considered a part of this Annual Report.

Mutual Holding Company Reorganization

On October 8, 2009, the Bank completed its conversion and reorganization from a mutual savings bank into a two-tier mutual holding stock company. In accordance with the plan of reorganization, Cullman Bancorp (of which Cullman Savings Bank became a wholly-owned subsidiary) issued and sold shares of capital stock to eligible depositors of Cullman Savings Bank. A total of 1,080,483 shares were sold in the conversion at $10 per share, raising $10.8 million of gross proceeds. Approximately $900,000 of conversion expenses were offset against the gross proceeds. Cullman Bancorp, Inc. s common stock began trading on the over-the-counter market under the symbol CULL on October 9, 2009.

The combination of shares sold to the public and contributed to the charitable foundation represents 45% of the common stock of Cullman Bancorp s outstanding shares. Cullman Savings Bank, MHC owns 55% or 1,382,012 shares.

Market Area and Competition

We conduct business through our main office and one branch office located in Cullman, Alabama and an additional branch office located in Hanceville, Alabama. All three of our offices are located in Cullman County, which is centrally located between the Huntsville and Birmingham metropolitan areas, approximately 55 miles south of Huntsville and approximately 50 miles north of Birmingham.

Our primary market area, which consists of Cullman County and the contiguous surrounding counties, is mostly rural and suburban in nature. The regional economy is fairly diversified, with services, wholesale/retail trade, manufacturing and government providing the primary support for the area economy. Farming also continues to play a prominent role in the local economy, as Cullman County is ranked as one of the top sixty counties in the United States for total agricultural income. The largest employers in Cullman County include the Cullman County and Cullman City School Systems, the State and County Government, Wal-Mart, the Cullman Regional Medical Center, REHAU, Inc. (a polymer processing company) and Golden Rod Broilers (a poultry processor).

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Competition for financial services in our primary market area is significant, particularly in light of the relatively modest population base of Cullman County and the relatively large number of institutions that maintain a presence in the county. Among our competitors are much larger and more diversified institutions, which have greater resources than we maintain. Financial institution competitors in our primary market area include other locally based thrifts and banks, as well as regional, super-regional and money center banks. To meet our competition, we seek to emphasize our community orientation, local and timely decision making and superior customer service. As of June 30, 2010 our market share of deposits represented 9.50% of FDIC-insured deposits in Cullman County, Alabama.

Lending Activities

Historically our principal lending activity is the origination one-to-four family residential mortgage loans and commercial real estate loans, and, to a lesser extent, multi-family mortgage loans, construction loans, land loans, home equity loans, commercial loans and consumer loans. In recent years we have expanded our commercial real estate loan portfolio in an effort to diversify our overall loan portfolio, increase the yield of our loans and shorten asset duration. We expect commercial real estate lending will continue to be an area of loan growth, and we have focused our efforts in this area on borrowers seeking loans in the $50,000 to $1.0 million range. As a long-standing community lender, we believe we can effectively compete for this business by emphasizing superior customer service and local underwriting, which differentiates us from larger commercial banks that have recently commenced operations in our primary market area.

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Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio by type of loan at the dates indicated.

	At December 31,									
	2010		2009		2008		2007		2006	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars In thousands)									
One- to four-family (1)	$ 83,721	46.88%	$ 81,436	46.79%	$ 80,454	48.34%	$ 84,925	51.59%	$ 84,011	56.40%
Multi-family	4,837	2.71	5,780	3.32	3,722	2.24	3,272	1.99	3,392	2.28
Commercial real estate	63,443	35.53	60,602	34.82	59,655	35.85	56,609	34.39	51,407	34.51
Construction	8,936	5.00	6,235	3.59	3,263	1.97	6,701	4.08	1,645	1.11
Total real estate loans	160,937	90.12	154,053	88.52	147,094	88.39	151,507	92.05	140,455	94.30
Commercial loans	7,371	4.13	7,506	4.31	6,592	3.96	1,414	0.86	169	0.11
Consumer loans:										
Home equity loans and lines of credit	6,165	3.45	7,543	4.33	7,321	4.40	5,539	3.37	2,882	1.93
Other consumer loans	4,111	2.30	4,936	2.84	5,411	3.25	6,141	3.73	5,444	3.65
Total consumer loans	10,276	5.75	12,479	7.17	12,732	7.65	11,680	7.10	8,326	5.59
Total loans	$ 178,584	100.00%	$ 174,038	100.00%	$ 166,418	100.00%	$ 164,601	100.00%	$ 148,950	100.00%
Net deferred loan fees	(413)		(544)		(703)		(874)		(938)	
Allowance for losses	(854)		(747)		(472)		(430)		(457)	
Loans, net	$ 177,317		$ 172,747		$ 165,243		$ 163,297		$ 147,555	

(1) Excludes loans held-for-sale

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Contractual Maturities and Interest Rate Sensitivity. The following table summarizes the scheduled repayments of our loan portfolio at December 31, 2010. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in one year or less.

	One-to-four Family Residential	Multi-family and Commercial Real Estate	Construction	Commercial	Home Equity Lines of Credit	Consumer and Other	Total
				(Dollars in thousands)			
Amounts due in:							
One year or less	$ 4,089	$ 5,479	$ 8,936	$ 4,051	$ 920	$ 1,630	$ 25,105
More than one to two years	355	5,754		770	1,562	811	9,252
More than two to three years	1,138	10,851		1,897	2,300	611	16,797
More than three to five years	3,087	10,192		653	1,383	1,015	16,330
More than five to ten years	5,989	4,103				44	10,136
More than ten to fifteen years	8,072	11,065					19,137
More than fifteen years	60,991	20,836					81,827
Total	$ 83,721	$ 68,280	$ 8,936	$ 7,371	$ 6,165	$ 4,111	$ 178,584
Interest rate terms on amounts due after one year:							
Fixed-rate loans	64,738	39,502		3,320	631	2,481	110,672
Adjustable-rate loans	14,894	23,299			4,614		42,807
Total	$ 79,632	$ 62,801	$	$ 3,320	$ 5,245	$ 2,481	$ 153,479

Loan Approval Procedures and Authority. Pursuant to federal law, the aggregate amount of loans that we are permitted to make to any one borrower or a group of related borrowers is generally limited to 15% of our unimpaired capital and surplus (25% if the amount in excess of 15% is secured by readily marketable collateral or 30% for certain residential development loans). At December 31, 2010, based on the 15% limitation, our loans-to-one-borrower limit was approximately $4.9 million. On the same date, we had no borrowers with outstanding balances in excess of this amount. At December 31, 2010, our largest commercial real estate loan totaled $3.5 million and was secured by a mortgage on commercial real estate in our primary market area. At December 31, 2010, this loan was performing in accordance with its terms.

Our lending is subject to written underwriting standards and origination procedures. Decisions on loan applications are made on the basis of detailed applications submitted by the prospective borrower and property valuations (consistent with our appraisal policy) prepared by outside independent licensed appraisers approved by our board of directors as well as internal evaluations, where permitted by regulations. The loan applications are designed primarily to determine the borrower s ability to repay the requested loan, and the more significant items on the application are verified through use of credit reports, financial statements and tax returns.

Under our loan policy, the individual processing an application is responsible for ensuring that all documentation is obtained prior to the submission of the application to an officer for approval. An officer then reviews these materials and verifies that the requested loan meets our underwriting guidelines described below.

Our senior lending officers have approval authority for real estate loans of up to $300,000, secured vehicle loans (including farm equipment) of up to $100,000 and unsecured loans of up to $100,000. Loans above these amounts require approval by any two of the following three officers: President and Chief Executive Officer, Executive Vice President and Director of Lending and Vice President/Senior Loan Officer. An individual loan or an aggregate credit commitment in excess of $1.5 million up to our legal lending limit requires the approval of all three of these officers and must be reported to our board of directors before the loan is closed. To ensure adequate liquidity, under our loan policy, aggregate loans outstanding should not exceed our total deposits and advances from the Federal Home Loan Bank of Atlanta.

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Generally, we require title insurance or abstracts on our mortgage loans as well as fire and extended coverage casualty insurance in amounts at least equal to the principal amount of the loan or the value of improvements on the property, depending on the type of loan.

***One- to-Four Family Residential Real Estate Lending*.** The cornerstone of our lending program has long been the origination of long-term permanent loans secured by mortgages on owner-occupied one- to four-family residences. At December 31, 2010, $83.7 million, or 46.9% of our total loan portfolio consisted of permanent loans on one- to four-family residences. At that date, our average outstanding one- to four-family residential loan balance was $108,000 and our largest outstanding residential loan had a principal balance of $2.2 million. Virtually all of the residential loans we originate are secured by properties located in our market area. See Originations, Purchases and Sales of Loans.

Due to consumer demand in the current low market interest rate environment, many of our recent originations are 15- to 30-year fixed-rate loans secured by one- to four-family residential real estate. We generally originate our fixed-rate one- to four-family residential loans in accordance with secondary market standards to permit their sale on a servicing-released basis. At December 31, 2010, we had $10.5 million of fixed-rate residential loans with original contractual maturities of 10 years or less, $9.3 million of fixed-rate residential loans with original contractual maturities between 10 and 20 years and $44.9 million of fixed-rate residential loans with original contractual maturities in excess of 20 years in our portfolio.

In order to reduce the term to repricing of our loan portfolio, we also originate adjustable-rate one- to four-family residential mortgage loans. Our current adjustable-rate mortgage loans carry interest rates that adjust annually at a margin (generally 300 basis points) over the Office of Thrift Supervision (OTS) Cost of Funds rate, which is a lagging index that generally adjusts more slowly than a U.S. Treasury index. Many of our adjustable-rate one- to four-family residential mortgage loans have fixed rates for initial terms of five or ten years. Such loans carry terms to maturity of up to 30 years. The adjustable-rate mortgage loans currently offered by us generally provide for a 100 basis point annual interest rate change cap and a lifetime cap of 400 basis points over the initial rate.

Although adjustable-rate mortgage loans may reduce to an extent our vulnerability to changes in market interest rates because they periodically reprice, as interest rates increase, the required payments due from the borrower also increase (subject to rate caps), increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustments of the contractual interest rate are also limited by the maximum periodic and lifetime rate adjustments permitted by our loan documents. Moreover, the interest rates on many of our adjustable-rate loans do not adjust for the first five to ten years. As a result, the effectiveness of adjustable-rate mortgage loans may be limited during periods of rapidly rising interest rates. At December 31, 2010, $14.9 million, or 17.8% of our one- to four-family residential loans, had adjustable rates of interest.

We evaluate both the borrower s ability to make principal, interest and escrow payments and the value of the property that will secure the loan. Our one- to-four family residential mortgage loans do not currently include prepayment penalties, are non-assumable and do not produce negative amortization. Our one- to-four family residential mortgage loans customarily include due-on-sale clauses giving us the right to declare the loan immediately due and payable in the event that, among other things, the borrower sells the property subject to the mortgage. We currently originate residential mortgage loans for our portfolio with loan-to-value ratios of up to 90% for owner-occupied one- to-four family homes and up to 80% for non-owner occupied homes.

At December 31, 2010, we had $179,000 of one- to-four family residential mortgage loans that were 60 days or more delinquent.

***Commercial Real Estate Lending*.** In recent years, we have sought to increase our commercial real estate loans. Our commercial real estate loans are secured primarily by office buildings, apartments, farms, retail and mixed-use properties, churches, warehouses and restaurants located in our primary market area. At December 31, 2010, we had $63.4 million in commercial real estate loans, representing 35.5% of our total loan portfolio.

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Most of our commercial real estate loans have a five-year balloon term with amortization periods of up to 20 years. The maximum loan-to-value ratio of our commercial real estate loans is generally 85%. At December 31, 2010, our largest commercial real estate loan totaled $3.5 million and was secured by a mortgage on a mixed use commercial building in our primary market area. At December 31, 2010, this loan was performing in accordance with its terms.

Classified within our commercial real estate loans are land loans. We also make a limited amount of land loans to complement our construction lending activities as such loans are generally secured by lots that will be used for residential development. Land loans also include loans secured by farm land and land purchased for investment purposes. Land loans are generally offered for terms of up to 15 years. The maximum loan-to-value ratio of land loans is 75%.

Set forth below is information regarding our commercial real estate loans:

Type of Loan	Number of Loans	Balance
	(Dollars in thousands)	
Office	13	$ 8,378
Farm	6	1,820
Retail	25	11,796
Mixed Use	25	9,962
Land	88	8,600
Church	9	9,122
Other	28	13,765
	194	$ 63,443

We consider a number of factors in originating commercial real estate loans. We evaluate the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the property securing the loan. When evaluating the qualifications of the borrower, we consider the financial resources of the borrower, the borrower s experience in owning or managing similar property and the borrower s payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service). All commercial real estate loans are appraised by outside independent appraisers approved by the board of directors or by internal evaluations, where permitted by regulation. Personal guarantees are generally obtained from the principals of commercial real estate borrowers and, in the case of church loans, guarantees from the applicable denomination are generally obtained.

Loans secured by commercial real estate generally are larger than one-to-four family residential loans and involve greater credit risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general, including today s economic recession. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate. At December 31, 2010, we had $156,000 of non-performing commercial real estate loans.

***Multi-Family Real Estate Lending*.** At December 31, 2010, we had $4.8 million in multi-family real estate loans, representing 2.7% of our total loan portfolio. The multi-family real estate loans we originate generally have a maximum term of 20 years and are secured by apartment buildings located within our primary market area. The interest rates on these loans are generally fixed for an initial period of three to five years and then adjust every one to five years based on the relevant OTS Cost of Funds Rate, plus a margin. These loans are generally made in amounts of up to 80% of the lesser of the appraised value or the purchase price of the property with an appropriate projected debt service coverage ratio.

Appraisals on properties securing multi-family real estate loans are performed by an outside independent appraiser designated by us or internal evaluations, where permitted by regulation. All appraisals on multi-family real estate loans are reviewed by our management. Our underwriting procedures include considering the borrower s expertise and require verification of the borrower s credit history, income and financial statements, banking relationships, references and income projections for the property. We generally obtain personal guarantees on these loans.

The borrower s financial information on multi-family loans is monitored on an ongoing basis by requiring periodic financial statement updates, payment history reviews and periodic face-to-face meetings with the borrower. We require such borrowers to provide annually updated financial statements and federal tax returns. These requirements also apply to the principals of our corporate borrowers.

At December 31, 2010, our largest multi-family loan had a balance of $1.4 million and was secured by a real estate mortgage on a 52-unit apartment complex in our primary market area. At December 31, 2010, this loan was performing in accordance with its terms.

Multi-family real estate loans generally present a higher level of risk than loans secured by one-to-four family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family residential real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed), the borrower s ability to repay the loan may be impaired. At December 31, 2010, we had no multi-family loans that were 60 days or more delinquent.

Construction Lending. We make construction loans to individuals for the construction of their primary residences and, to a limited extent, loans to builders and commercial borrowers for owner-occupied projects. At December 31, 2010, our construction loans totaled $8.9 million, representing 5.0% of our total loan portfolio.

Loans to individuals for the construction of their residences typically run for up to 12 months and then convert to permanent loans. These construction loans have rates and terms comparable to one-to-four family residential loans offered by us. During the construction phase, the borrower pays interest only. The maximum loan-to-value ratio of owner-occupied single-family construction loans is 85%. Residential construction loans are generally underwritten pursuant to the same guidelines used for originating permanent residential loans.

At December 31, 2010, our largest outstanding commercial construction loan was for $2.4 million of which $2.4 was outstanding. This loan was performing according to its terms at December 31, 2010. At December 31, 2010, there were no construction loans that were 60 days or more delinquent.

The application process for a construction loan includes a submission to us of accurate plans, specifications and costs of the project to be constructed or developed. These items are used as a basis to determine the appraised value of the subject property. Loans are based on the lesser of current appraised value and/or the cost of construction (land plus building). Our construction loan agreements generally provide that loan proceeds are disbursed in increments as construction progresses. Outside independent licensed appraisers inspect the progress of the construction of the dwelling before disbursements are made.

Construction loans generally are made for relatively short terms. However, to the extent our construction loans are not made to owner-occupants of single-family homes, they are more vulnerable to changes in economic conditions and the concentration of credit with a limited number of borrowers. Further, the nature of these loans is such that they are more difficult to evaluate and monitor. Our risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value upon completion of the project and the estimated cost (including interest) of the project. If the estimate of value proves to be inaccurate, we may be confronted, at or prior to the maturity of the loan, with a project value, which is insufficient to assure full repayment and/or the possibility of having to make substantial investments to complete and sell the project. Because defaults in repayment may not occur during the construction period, it may be difficult to identify problem loans at an early stage.

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Commercial Business Lending. We originate commercial business loans and lines of credit to small- and medium-sized companies in our primary market area. Our commercial business loans are generally used for working capital purposes or for acquiring equipment, inventory or furniture. The commercial business loans that we offer are floating-rate loans indexed to the prime rate as published in *The Wall Street Journal* and fixed-rate loans generally for a one-year term. Our commercial business loan portfolio consists primarily of secured loans, along with a small amount of unsecured loans.

At December 31, 2010, we had $7.4 million of commercial business loans outstanding, representing 4.1% of the total loan portfolio.

When making commercial business loans, we consider the financial statements of the borrower, the lending history of the borrower, the debt service capabilities of the borrower, the projected cash flows of the business, the value of the collateral, if any, and whether the loan is guaranteed by the principals of the borrower. Commercial business loans are generally secured by accounts receivable, inventory and equipment.

Commercial business loans generally have a greater credit risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower s ability to make repayment from his or her employment and other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. We seek to minimize these risks through our underwriting standards.

At December 31, 2010, our largest commercial business loan relationship was an $837,000 loan to a medical company secured by medical equipment and limited personal guarantees by several individuals, including one of our directors. At December 31, 2010, this loan was performing in accordance with its terms. At December 31, 2010, we had no commercial business loans that were 60 days or more delinquent.

Home Equity Lending. We originate variable-rate and fixed-rate home equity lines-of-credit secured by a lien on the borrower s primary residence. Our home equity products are limited to 90% of the property value less any other mortgages. We use the same underwriting standards for home equity lines-of-credit as we use for one-to-four family residential mortgage loans. Our variable-rate home equity line-of-credit product carries an interest rate tied to the prime rate published in *The Wall Street Journal* with a margin that ranges from (100) basis points to 250 basis points. Our home equity lines-of-credit provide for an initial draw period of up to five years, with monthly payments of 1.5% of the outstanding balance or interest only payments calculated on the outstanding balance. At the end of the initial five years, the line may be paid in full or restructured through our then current home equity program.

At December 31, 2010, we had $6.2 million or 3.5% of our total loans in home equity loans and outstanding advances under home equity lines and an additional $6.0 million of funds committed, but not advanced, under the home equity lines-of-credit.

Consumer Lending. To date, our consumer lending apart from home equity lines-of-credit has been quite limited. At December 31, 2010, we had $4.1 million of consumer loans outstanding, representing 2.3% of the total loan portfolio. Consumer loans consist of loans secured by deposits, auto loans and miscellaneous other types of installment loans.

Consumer loans may entail greater credit risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At December 31, 2010, we had $125,000 of consumer loans that were 60 days or more delinquent.

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Originations, Purchases and Sales of Loans

Lending activities are conducted primarily by our salaried loan personnel operating at our main and branch office locations and a commissioned loan officer. All loans originated by us are underwritten pursuant to our policies and procedures. We originate both fixed-rate and adjustable-rate loans. Our ability to originate fixed or adjustable-rate loans is dependent upon relative customer demand for such loans, which is affected by current and expected future levels of market interest rates. We originate real estate and other loans through our commissioned loan officer, marketing efforts, our customer base, walk-in customers and referrals from real estate brokers, builders and attorneys.

We may sell certain of the loans we originate into the secondary market. Additionally, we consider the current interest rate environment in making decisions as to whether to hold the mortgage loans we originate for investment or to sell such loans to investors, choosing the strategy that is most advantageous to us from a profitability and risk management standpoint. At December 31, 2010, we had $320,000 in loans held for sale. Generally, we have not retained the servicing rights on the mortgage loans sold in the secondary mortgage market.

From time to time, to diversify our risk, we will purchase or sell interests in loans. We underwrite our participation portion of the loan according to our own underwriting criteria and procedures. At December 31, 2010, we had $3.5 million in loan participation interests.

We generally do not purchase whole loans from third parties to supplement our loan production.

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The following table shows our loan origination and principal repayment activity for loans originated for our portfolio during the periods indicated.

	Years Ended December 31, 2010	2009
	(Dollars in thousands)	
Total loans at beginning of period	$ 174,038	$ 166,418
Loans originated:		
Real estate loans:		
One- to four-family	$ 13,198	$ 11,255
Multi-family		2,075
Commercial real estate	11,158	10,850
Construction	8,421	7,276
Total real estate loans	32,777	31,456
Commercial loans	2,678	5,715
Consumer loans:		
Home equity loans and lines of credit	445	1,331
Other consumer loans	1,989	3,373
Total loans originated	37,889	41,875
Deduct:		
Principal repayments	(33,343)	(34,255)
Net loan activity	4,546	7,620
Total loans at end of period	$ 178,584	$ 174,038

The following table shows loan origination and sale activity for one- to-four family residential mortgage loans originated for sale during the periods indicated. No other loans were originated for sale during the periods indicated.

	Years Ended December 31, 2010	2009
	(Dollars in thousands)	
Total mortgage loans at the beginning of the period	$ 445	$ 245
Mortgage loans originated for sale	15,020	15,077
Mortgage loans sold	(15,145)	(14,877)
Total mortgage loans at the end of the period	$ 320	$ 445

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Delinquencies and Non-Performing Assets

Delinquency Procedures. When a borrower fails to make a required monthly loan payment by the last day of the month, a late notice is generated stating the payment and late charges due. Our policies provide borrowers that become 60 days or more delinquent are contacted by phone or mail to determine the reason for nonpayment and to discuss future payments, although in practice we generally contact such borrowers within 30 days. If repayment is not possible or doubtful, the loan will be brought to the board of directors for possible foreclosure. Once the board of directors declares a loan due and payable, a certified letter is sent to the borrower explaining the entire balance of the loan is due and payable. The borrower is permitted ten additional days to submit payment. If the loan is reinstated, foreclosure proceedings will be discontinued and the borrower will be permitted to continue to make payments. If the borrower does not respond, we will initiate foreclosure proceedings.

When we acquire real estate as a result of foreclosure or by deed in lieu of foreclosure, the real estate is classified as foreclosed real estate until it is sold. The real estate is recorded at estimated fair value at the date of acquisition less estimated costs to sell, and any write-down resulting from the acquisition is charged to the allowance for loan losses. Subsequent decreases in the value of the property are charged to operations through the creation of a valuation allowance. After acquisition, all costs incurred in maintaining the property are expensed. Costs relating to the development and improvement of the property, however, are capitalized to the extent of estimated fair value less estimated costs to sell.

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Delinquent Loans. The following table sets forth certain information with respect to our loan portfolio delinquencies by type and amount as of the date indicated:

	30-59 Days		60-89 Days		90 Days and Over		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
At December 31, 2010	(Dollars in thousands)							
Real estate loans:								
One- to four-family	6	$ 654	2	$ 118	2	$ 61	10	$ 833
Multi-family	1	613					1	613
Commercial real estate			1	107	2	156	3	263
Construction								
Total real estate loans	7	1,267	3	225	4	217	14	1,709
Commercial loans								
Consumer loans:								
Home equity loans and lines of credit	1	75	1	120		4	2	199
Other consumer loans	2	7	2	1	1		5	8
Total	10	$ 1,349	6	$ 346	5	$ 221	21	$ 1,916

At December 31, 2009