SI Financial Group, Inc.
Form 10-K
March 28, 2011

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

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

For the Transition Period from _______ to _______

Commission File Number: 0-54241

SI FINANCIAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	80-0643149 (I.R.S. Employer Identification No.)
803 Main Street, Willimantic, Connecticut (Address of principal executive offices)	06226 (Zip Code)

(860) 423-4581
(Registrant’s telephone number, including area code)

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

Title of each class	Name of Exchange on which registered
Common stock, par value $0.01 per share	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes o No o

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

Large Accelerated Filer o Accelerated Filer o

Non-Accelerated Filer   x   Smaller Reporting Company Filer o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was $26.4 million, which was computed by reference to the closing price of $6.30, at which the common equity was sold as of June 30, 2010. Solely for the purposes of this calculation, the shares held by SI Bancorp, MHC and the directors and officers of the registrant are deemed to be affiliates.

As of March 15, 2011, there were 10,576,849 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Annual Report to Shareholders and the Proxy Statement for the 2011 Annual Meeting of Shareholders are incorporated by reference into Parts II and III of this Form 10-K.

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Explanatory Note

SI Financial Group, Inc., a Maryland corporation (the "Registrant" or "SI Financial–Maryland"), was incorporated on September 7, 2010 to become the holding company for Savings Institute Bank and Trust Company (the "Bank") upon completion of the "second-step" conversion of the Bank from a mutual holding company structure to a stock holding company structure (the "Conversion"). The Conversion involved the sale by the Registrant of 6,544,493 shares of common stock in a public offering to depositors and community members, the exchange of 4,032,356 shares of common stock of the Registrant for shares of common stock of the former SI Financial Group, Inc. (the "Company") held by persons other than SI Bancorp, MHC (the "MHC"), and the elimination of the Company and the MHC. The Conversion was completed on January 12, 2011. As the Conversion was completed after December 31, 2010, the information in this report is for the Company. Separate financial statements for the Registrant have not been included in this report because the Registrant, as of December 31, 2010, had not issued any shares and had engaged only in organizational activities to date, had no significant assets, contingent or other liabilities, revenues or expenses. Per share information in this report is based on outstanding shares as of the dates indicated and does not reflect the Conversion. Following the Conversion, the Registrant had 10,576,849 shares of common stock outstanding.

Forward-Looking Statements

This report may contain certain "forward-looking statements" within the meaning of the federal securities laws, which are made in good faith pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements are not historical facts; rather, they are statements based on management's current expectations regarding our business strategies, intended results and future performance. Forward-looking statements are generally preceded by terms such as "expects," "believes," "anticipates," "intends," "estimates," "projects" and similar expressions. Management's ability to predict results of the effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, national and regional economic conditions, legislative and regulatory changes, monetary and fiscal policies of the United States government, including policies of the United States Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area, changes in real estate market values in the Company's market area and changes in relevant accounting principles and guidelines. Additional factors that may affect the Company's results are discussed in Item 1A. "Risk Factors" in the Company's annual report on Form 10-K and in other reports filed with the Securities and Exchange Commission. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Except as required by applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

PART I.

Item 1. Business.

General

In certain instances where appropriate, the terms "we," "us" and "our" refer to SI Financial Group, Inc. and Savings Institute Bank and Trust Company or both.

SI Financial Group, Inc. was established on August 6, 2004 to become the parent holding company for the Bank upon the conversion of the Bank's former parent, SI Bancorp, Inc., from a state-chartered to a federally-chartered mutual holding company. At the same time, the Bank also converted from a state-chartered to a federally-chartered savings bank. On September 30, 2004, the Company completed its minority stock offering with the sale of 5,025,500 shares of its common stock to the public, 251,275 shares contributed to SI Financial Group Foundation and 7,286,975 issued to the MHC. The Bank is a wholly-owned subsidiary of the Company and management of the Company and the Bank are substantially similar. The Company neither owns nor leases any property, but instead uses the premises, equipment and other property of the Bank with the payment of appropriate rental fees, as required by applicable law and regulations. Thus, the financial information and discussion contained herein primarily relates to the activities of the Bank.

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On January 12, 2011, SI Financial-Maryland completed its public stock offering and the concurrent conversion of the Bank from the mutual holding company structure to a stock holding company structure. A total of 6,544,493 shares of common stock were sold in the subscription and community offerings at $8.00 per share, including 392,670 shares purchased by the Bank's Employee Stock Ownership Plan. Additional shares totaling 4,032,356 were issued in exchange for shares of the former federally-chartered SI Financial Group, Inc., at an exchange ratio of 0.8981. See Note 22 in the Company's Consolidated Financial Statements included in the Company's Annual Report to Shareholders, attached hereto as Exhibit 13, for more details.

The Bank operates as a community-oriented financial institution offering a full range of financial services to consumers and businesses in its market area, including insurance, trust and investment services. The Bank attracts deposits from the general public and uses those funds to originate one- to four-family residential, multi-family and commercial real estate, commercial business and consumer loans. Beginning in 2008, substantially all of the fixed-rate one- to four-family residential conforming loans the Bank originates are sold in the secondary market with the servicing retained. Such sales generate mortgage banking fees. The remainder of the Bank's loan portfolio is originated for investment.

Availability of Information

The Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to such reports filed or furnished pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, are made available free of charge on the Company's website, www.mysifi.com, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission (the "SEC"). The information on the Company's website shall not be considered as incorporated by reference into this Form 10-K.

Market Area and Competition

The Company is headquartered in Willimantic, Connecticut, which is located in eastern Connecticut approximately 30 miles east of Hartford. The Bank operates 21 full-service offices throughout Windham, New London, Tolland, Hartford and Middlesex counties in Connecticut. The Bank's primary lending area is eastern Connecticut and most of the Bank's deposit customers reside in the areas surrounding the Bank's branch offices. The economy in the Company's market area is relatively diverse and primarily oriented to the educational, service, entertainment, manufacturing and retail industries. The major employers in the area include several institutions of higher education, the Mohegan Sun and Foxwoods casinos, General Dynamics Defense Systems and Pfizer, Inc. In addition, there are also many small to mid-sized businesses that support the local economy.

In view of the current economic downturn, our primary market area has remained a relatively stable banking market. Windham, New London, Tolland, Hartford and Middlesex counties have a total population of 1.6 million and total households of 616,000 according to SNL Financial. For 2010, median household income levels ranged from $58,000 to $78,000 in the five counties we maintain branch offices, compared to $70,000 for Connecticut as a whole and $54,000 for the United States according to published statistics.

The Bank faces significant competition for the attraction of deposits and origination of loans. The most direct competition for deposits has historically come from the several financial institutions operating in the Bank's market area and, to a lesser extent, from other financial service companies, such as brokerage firms, credit unions and insurance companies. The Bank also faces competition for investors' funds from money market funds and other corporate and government securities. At June 30, 2010, which is the most recent date for which data is available from the Federal Deposit Insurance Corporation (the "FDIC"), the Bank held 20.69% of the deposits in Windham County, which is the largest market share out of 10 financial institutions with offices in this county. Also, at June 30, 2010, the Bank held 0.96% of the deposits in New London, Tolland, Hartford and Middlesex Counties, which is the 16th market share out of 35 financial institutions with offices in these counties. Bank of America Corp., Webster Bank Financial Corporation, The Toronto-Dominion Bank, People's United Financial, Inc. and Banco Santander, S.A., all of which are large national or regional bank holding companies, also operate in the Bank's market area. These institutions are significantly larger and, therefore, have significantly greater resources than the Bank does and may offer products and services that the Bank does not provide.

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The Bank's competition for loans comes primarily from financial institutions in its market area, and to a lesser extent from other financial service providers, such as mortgage companies and mortgage brokers. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage market, such as insurance companies, securities companies and specialty finance companies.

The Bank expects competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered barriers to entry, allowed banks to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Changes in federal law permit affiliation among banks, securities firms and insurance companies, which promotes a competitive environment in the financial services industry. Competition for deposits and the origination of loans could limit the Company's growth in the future.

Lending Activities

General. The Bank's loan portfolio consists primarily of one- to four-family residential mortgage loans, multi-family and commercial real estate loans and commercial business loans. To a much lesser extent, the loan portfolio includes construction and consumer loans. At December 31, 2010, the Bank had loans held for sale totaling $7.4 million.

The following table summarizes the composition of the Bank's loan portfolio at the dates indicated.

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(Dollars in Thousands)	At December 31, 2010 Amount	2010 Percent of Total	2009 Amount	2009 Percent of Total	2008 Amount	2008 Percent of Total	2007 Amount	2007 Percent of Total	2006 Amount	2006 Percent of Total
Real estate loans:										
Residential - 1 to 4 family	$270,923	44.46 %	$306,244	50.12 %	$332,399	53.46 %	$330,389	55.87 %	$309,695	53.65 %
Multi-family and commercial	160,015	26.26	159,781	26.15	158,693	25.52	132,819	22.46	118,600	20.55
Construction	6,952	1.14	11,400	1.87	27,892	4.49	37,231	6.29	44,647	7.73
Total real estate loans	437,890	71.86	477,425	78.14	518,984	83.47	500,439	84.62	472,942	81.93
Commercial business loans:										
SBA and USDA guaranteed	116,492	19.11	77,310	12.65	45,704	7.35	42,267	7.15	51,358	8.90
Other	26,310	4.32	30,239	4.95	34,945	5.62	27,583	4.66	23,813	4.13
Total commercial business loans	142,802	23.43	107,549	17.60	80,649	12.97	69,850	11.81	75,171	13.03
Consumer loans:										
Home equity	25,533	4.19	22,573	3.69	18,762	3.02	17,774	3.01	18,489	3.20
Other	3,167	0.52	3,513	0.57	3,345	0.54	3,330	0.56	10,616	1.84
Total consumer loans	28,700	4.71	26,086	4.26	22,107	3.56	21,104	3.57	29,105	5.04
Total loans	609,392	100.00%	611,060	100.00%	621,740	100.00%	591,393	100.00%	577,218	100.00%
Deferred loan origination costs, net of deferred fees	1,621		1,523		1,570		1,390		1,258	
Allowance for loan losses	(4,799)		(4,891)		(6,047)		(5,245)		(4,365)	
Loans receivable,	$606,214		$607,692		$617,263		$587,538		$574,111	

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One- to Four-Family Residential Loans. The Bank's primary lending activity is the origination of mortgage loans to enable borrowers to purchase or refinance existing homes or to construct new residential dwellings in its market area. The Bank offers fixed-rate and adjustable-rate mortgage loans with terms up to 30 years. Borrower demand for adjustable-rate loans versus fixed-rate loans is a function of the level of current and anticipated future interest rates, the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and the initial period interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate mortgage loans and adjustable-rate mortgage loans that can be originated at any time is largely determined by the demand for each in a competitive environment and the effect each has on the Bank's interest rate risk. The loan fees charged, interest rates and other provisions of mortgage loans are determined on the basis of the Bank's pricing criteria and competitive market conditions.

The Bank offers fixed-rate loans with terms of 10, 15, 20 or 30 years. The Bank's adjustable-rate mortgage loans are based primarily on 30-year amortization schedules. Interest rates and payments on adjustable-rate mortgage loans adjust annually after a one, three, five, seven or ten-year initial fixed period. Interest rates and payments on adjustable-rate loans are adjusted to a rate typically equal to 2.75% (2.875% for jumbo loans) above the one-year constant maturity Treasury index. The maximum amount by which the interest rate may be increased or decreased is generally 2% per adjustment period and the lifetime interest rate cap is generally 6% over the initial interest rate of the loan.

Generally, the Bank does not originate conventional loans with loan-to-value ratios exceeding 95% and generally originates loans with a loan-to-value ratio in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance or additional collateral. The Bank requires all properties securing mortgage loans to be appraised by a board approved independent licensed appraiser and requires title insurance on all first mortgage loans. Borrowers must obtain hazard insurance and flood insurance for loans on property located in a flood zone before closing the loan.

In an effort to provide financing for moderate income and first-time buyers, the Bank offers loans insured by the Federal Housing Administration and the Veterans Administration and participates in the Connecticut Housing Finance Authority Program. The Bank offers fixed-rate residential mortgage loans through these programs to qualified individuals and originates the loans using modified underwriting guidelines.

Multi-Family and Commercial Real Estate Loans. The Bank makes multi-family and commercial real estate loans throughout its market area for the purpose of acquiring, developing, improving or refinancing multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The Bank offers fixed-rate and adjustable-rate mortgage loans secured by multi-family and commercial real estate. The Bank's multi-family and commercial real estate loans are generally secured by owner-occupied properties, including churches, retail facilities and other owner-occupied properties located in its market area and used for businesses. The Bank intends to continue to emphasize this segment of its loan portfolio, as market conditions permit, as such loans produce yields that are generally higher than one- to four-family residential loans and are more sensitive to changes in market interest rates.

The Bank originates adjustable-rate multi-family and commercial real estate loans for amortization periods up to 25 years. Interest rates and payments on these loans typically adjust every five years after a five-year initial fixed-rate period. Interest rates and payments on adjustable-rate loans are adjusted to a rate typically 2.5-3.0% above the classic advance rates offered by the Federal Home Loan Bank of Boston (the "FHLB"). There are no adjustment period or lifetime interest rate caps. Loans are secured by first mortgages that generally do not exceed 75% of the property's appraised value. At December 31, 2010, the largest outstanding multi-family or commercial real estate loan was $7.0 million. This loan is secured by a nursing home and rehabilitation facility and was performing according to its terms at December 31, 2010.

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Construction and Land Loans. The Bank originates loans to individuals, and to a lesser extent, builders, to finance the construction of residential dwellings. The Bank also originates construction loans for commercial development projects, including condominiums, apartment buildings, single-family subdivisions as well as owner-occupied properties used for businesses. Residential construction loans generally provide for the payment of interest only during the construction phase, which is usually twelve months. At the end of the construction phase, the loan generally converts to a permanent mortgage loan. Commercial construction loans generally provide for the payment of interest only during the construction phase which may range from three to twenty-four months. Loans generally can be made with a maximum loan-to-value ratio of 80% on residential construction, 75% on construction for nonresidential properties and 80% of the lesser of the appraised value or cost of the project on multi-family construction. At December 31, 2010, the largest outstanding commercial construction loan commitment for the construction of a residential housing development was $2.0 million, of which $144,000 was outstanding and the largest residential construction loan commitment was $1.8 million, of which $1.5 million was outstanding. These loans were performing according to their terms at December 31, 2010. Primarily all commitments to fund construction loans require an appraisal of the property by a board approved independent licensed appraiser. Also, inspections of the property are required before the disbursement of funds during the term of the construction loan.

The Bank also originates land loans to individuals, local contractors and developers only for making improvements on approved building lots, subdivisions and condominium projects within two years of the date of the loan. Such loans to individuals generally are written with a maximum loan-to-value ratio based upon the appraised value or purchase price of the land. Maximum loan-to-value ratio on raw land is 50%, while the maximum loan-to-value ratio for land development loans involving approved projects is 65%. The Bank offers fixed-rate land loans and variable-rate land loans that adjust annually. Interest rates and payments on adjustable-rate land loans are adjusted to a rate typically equal to the then current prime rate as reported in The Wall Street Journal plus a 1.0–2.0% margin. The maximum amount by which the interest rate may be increased or decreased is generally 2% annually and the lifetime interest rate cap is generally 6% over the initial rate of the loan. Land loans totaled $532,000 at December 31, 2010.

Commercial Business Loans. The Bank originates commercial business loans to a variety of professionals, sole proprietorships and small businesses primarily in its market area. The Bank offers a variety of commercial lending products, the maximum amount of which is limited by the Bank’s in-house loans to one borrower limit. At December 31, 2010, the largest commercial loan was a $1.4 million loan, which is secured by a clinical office building. This loan was performing according to its terms at December 31, 2010.

The Bank offers loans secured by business assets other than real estate, such as business equipment and inventory. These loans are originated with maximum loan-to-value ratios of 75% of the value of the personal property. The Bank originates lines of credit to finance the working capital needs of businesses to be repaid by seasonal cash flows or to provide a period of time during which the business can borrow funds for planned equipment purchases. These loans convert to a term loan at the expiration of a draw period, which is not to exceed twelve months, and will be paid over a pre-defined amortization period. Additional products such as time notes, letters of credit and equipment lease financing are offered. Additionally, the Bank purchases the portion of commercial business loans that are fully guaranteed by the Small Business Administration (“SBA”) and the United States Department of Agriculture (“USDA”). At December 31, 2010, purchased SBA and USDA loans totaled $116.5 million.

When originating commercial business loans, the Bank considers the financial statements of the borrower, the borrower’s payment history of both corporate and personal debt, the debt service capabilities of the borrower, the projected cash flows of the business, viability of the industry in which the customer operates and the value of the collateral.

Consumer Loans. The Bank offers a variety of consumer loans, primarily home equity lines of credit, and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles, as well as unsecured loans. Generally, the Bank offers automobile loans with a maximum loan-to-value ratio of 100% of the purchase price for new vehicles. Unsecured loans generally have a maximum borrowing limit of $10,000 and a maximum term of five years.

The procedures for underwriting consumer loans include an assessment of the applicant's payment history on other debts and their ability to meet existing obligations and payments on the proposed loans. Although the applicant's creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount. Home equity lines of credit have adjustable rates of interest that are indexed to the prime rate as reported in The Wall Street Journal. A home equity line of credit may be drawn down by the borrower for an initial period of five years from the date of the loan agreement. During this period, the borrower has the option of paying, on a monthly basis, either principal and interest or only interest. If the draw period is not extended for an additional 4 years and 10 months, the borrower has to pay back the amount outstanding under the line of credit over a term not to exceed ten years, beginning at the end of the five-year period. The Bank will offer home equity loans with a maximum combined loan-to-value ratio of 80%.

Loan Underwriting Risks. While the Bank anticipates that adjustable-rate loans will better offset the adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability and collateral value of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make the Bank's loan portfolio more responsive to changes in interest rates, the extent of this interest sensitivity is limited by the annual and lifetime interest rate adjustment limits.

Loans secured by multi-family and commercial real estate generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in multi-family and commercial real estate lending is the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income-producing properties, the Bank generally requires borrowers and loan guarantors to provide annual financial statements and/or tax returns. In reaching a decision on whether to make a multi-family or commercial real estate loan, consideration is given to the net operating income of the property, the borrower's expertise, credit history and the profitability and value of the underlying property. The Bank generally requires that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x. Environmental screens, surveys and inspections are obtained when circumstances suggest the possibility of the presence of hazardous materials. Further, in connection with our ongoing monitoring of the loan, the Bank typically reviews the property, the underlying loan and guarantors annually.

Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction, the estimated cost (including interest) of construction and the ability of the project to be sold upon completion. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the building. If the estimate of value proves to be inaccurate, the Bank may be confronted, at or before the maturity of the loan, with a building having a value that is insufficient to assure full repayment. If the Bank is forced to foreclose on a building before or at completion due to a borrower default, the Bank may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

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

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Consumer loans may entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant significant collection efforts against the borrower. In addition, consumer loan collections depend on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. 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.

Loan Originations, Purchases, Sales and Servicing. Loan originations come from a number of sources. The primary source of loan originations are the Bank's in-house loan originators, and to a lesser extent, advertising and referrals from customers.

Regularly, the Bank will purchase whole participations in loans fully guaranteed by the SBA and the USDA. The loans are primarily for commercial and agricultural properties located throughout the United States. The Bank purchased $54.0 million and $40.9 million in loans during 2010 and 2009, respectively.

At December 31, 2010, the Bank was a participating lender on three loans totaling $4.3 million, which are secured by commercial real estate. These loans are serviced by the lead lenders. The Bank generally performs its own underwriting analysis before purchasing loans and therefore believes there should not be a greater risk of default on these obligations. However, in a purchased participation loan, the Bank does not service the loan and thus are subject to the policies and practices of the lead lender with regard to monitoring delinquencies, pursuing collections and instituting foreclosure proceedings.

The Bank originates conventional conforming one- to four-family loans which meet Fannie Mae underwriting standards. Beginning in 2008, substantially all one- to four-family residential conforming loans have been sold in the secondary market on a servicing retained basis. Such loans are sold to Fannie Mae, the Connecticut Housing Finance Authority and the FHLB under the Mortgage Partnership Finance Program ("MPF"). The decision to sell loans in the secondary market is based on prevailing market interest rate conditions, an analysis of the composition and risk of the loan portfolio, liquidity needs and interest rate risk management. Generally, loans are sold without recourse. The Bank utilizes the proceeds from these sales primarily to meet liquidity needs. Proceeds from the sale of loans totaled $49.1 million and $56.9 million for the years ended December 31, 2010 and 2009, respectively. The Bank intends to continue to originate these types of loans for sale in the secondary market in the future to increase its noninterest income.

At December 31, 2010, the Bank retained the servicing rights on $148.6 million of loans for others, consisting primarily of fixed-rate mortgage loans sold with or without recourse to third parties. Loan repurchase commitments are agreements to repurchase loans previously sold upon the occurrence of conditions established in the contract, including default by the underlying borrower. At December 31, 2010, the balance of loans sold with recourse totaled $19,000. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent mortgagors, processing insurance and tax payments on behalf of borrowers, assisting in foreclosures and property dispositions when necessary and general administration of loans.

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The following table sets forth the Bank's loan originations, loan purchases, loan sales, principal repayments, net charge-offs and other reductions on loans for the years indicated.

	Years Ended December 31,		
(In Thousands)	2010	2009	2008
Loans at beginning of year	$ 611,060	$ 621,740	$ 591,393
Originations:			
Real estate loans	104,497	129,948	118,113
Commercial business loans	5,337	4,386	15,778
Consumer loans	12,210	11,990	7,697
Total loan originations	122,044	146,324	141,588
Purchases	53,953	40,876	12,281
Deductions:			
Principal loan repayments, prepayments and other, net	125,719	131,940	108,693
Loan sales	49,107	56,336	14,232
Loan charge-offs	1,015	4,075	597
Transfers to other real estate owned	1,824	5,529	-
Total deductions	177,665	197,880	123,522
Net (decrease) increase in loans	(1,668)	(10,680)	30,347
Loans at end of year	$ 609,392	$ 611,060	$ 621,740

Loan Maturity. The following table shows the contractual maturity of the Bank's loan portfolio at December 31, 2010. The table does not reflect any estimate of prepayments, which significantly shortens the average life of all loans and may cause actual repayment experience to differ from that shown below. Demand loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less. The amounts shown below exclude deferred loan fees and costs.

	Amounts Due In			
(In Thousands)	One Year or Less	More Than One Year to Five Years	More Than Five Years	Total Amount Due
Real estate loans:				
Residential - 1 to 4 family	$ 116	$ 6,833	$ 263,974	$ 270,923
Multi-family and commercial	321	6,160	153,534	160,015
Construction	1,185	-	5,767	6,952
Total real estate loans	1,622	12,993	423,275	437,890
Commercial business loans	9,214	8,748	124,840	142,802
Consumer loans	269	1,382	27,049	28,700

Total loans	$ 11,105	$ 23,123	$ 575,164	$ 609,392

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While one- to four-family residential real estate loans are normally originated with terms of up to 30 years, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon the sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase, sale and refinancing activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.

The following table sets forth the dollar amount of all scheduled maturities of loans at December 31, 2010 that are due after December 31, 2011, and have either fixed interest rates or adjustable interest rates.

	Due After December 31, 2011		
(In Thousands)	Fixed Rates	Floating or Adjustable Rates	Total
Real estate loans:			
Residential - 1 to 4 family	$ 184,768	$ 86,039	$ 270,807
Multi-family and commercial	13,366	146,328	159,694
Construction	5,614	153	5,767
Total real estate loans	203,748	232,520	436,268
Commercial business loans	44,896	88,692	133,588
Consumer loans	7,765	20,666	28,431
Total loans	$ 256,409	$ 341,878	$ 598,287

Loan Approval Procedures and Authority. The Bank's lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by the Company's Board of Directors and management. All residential mortgages and home equity lines of credit in excess of $6.0 million or all commercial loans and other consumer loans in excess of $2.0 million require the approval of the Board of Directors. The Loan Committee of the Board of Directors has the authority to approve: (1) residential mortgage loans and consumer home equity lines of credit up to $6.0 million and (2) commercial and other consumer loans up to $2.0 million. The President and the Senior Credit Officer have approval for: (1) residential mortgage loans that conform to Fannie Mae and Freddie Mac standards up to $2.0 million or $417,000 for those that are non-conforming and (2) consumer and commercial loans up to $250,000 individually or $2.0 million jointly for home equity lines of credit or $1.0 million jointly for commercial and other consumer loans. Additionally, certain loan and branch personnel have the authority to approve residential mortgage loans up to $417,000, home equity lines up to $250,000 and consumer loans up to $100,000.

Loans to One Borrower. The maximum amount that the Bank may lend to one borrower and the borrower's related entities is limited, by regulation, to 15% of the Bank's stated capital and reserves. At December 31, 2010, the Bank's general regulatory limit on loans to one borrower was approximately $11.4 million. At that date, the Bank's largest lending relationship was $8.1 million, representing a commercial business loan, two commercial real estate loans for a nursing home and rehabilitation facility and a commercial real estate loan to purchase an adjacent property. These loans were performing according to their terms at December 31, 2010.

Loan Commitments. The Bank issues commitments for fixed- and adjustable-rate mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements to lend to customers. Generally, our mortgage loan commitments expire in 60 days or less from the date of the application.

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Delinquencies. When a borrower fails to make a required loan payment, the Bank takes a number of steps to have the borrower cure the delinquency and restore the loan to current status. The Bank makes initial contact with the borrower when the loan becomes 15 days past due. If payment is not then received by the 30th day of delinquency, additional letters and phone calls generally are made. When the loan becomes 90 days past due, a letter is sent notifying the borrower that foreclosure proceedings will commence if the loan is not brought current within 30 days. Generally, when the loan becomes 120 days past due, the Bank will commence foreclosure proceedings against any real property that secures the loan or attempt to repossess any personal property that secures a consumer or commercial loan. If a foreclosure action is instituted and the loan is not brought current, paid in full or refinanced before the foreclosure sale, the real property securing the loan is typically sold at foreclosure. The Bank may consider loan repayment arrangements with certain borrowers under certain circumstances.

Management reports monthly to the Board of Directors or a committee of the Board regarding the amount of loans delinquent 30 days or more, all loans in foreclosure and all foreclosed and repossessed property that the Bank owns.

The following table provides information about delinquencies in the Bank's loan portfolio at the dates indicated.

	December 31, 2010				December 31, 2009			
	60-89 Days		90 Days or More		60-89 Days		90 Days or More	
(Dollars in Thousands)	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans	Number of Loans	Principal Balance of Loans
Real estate loans:								
Residential - 1 to 4 family	9	$1,291	19	$2,364	2	$484	14	$2,393
Multi-family and commercial	-	-	1	44	-	-	-	-
Construction	-	-	1	82	-	-	1	375
Total real estate loans	9	1,291	21	2,490	2	484	15	2,768
Commercial business loans:								
SBA and USDA guaranteed	-	-	-	-	-	-	-	-
Other	-	-	1	46	1	8	1	27
Total commercial business loans	-	-	1	46	1	8	1	27
Consumer loans:								
Home equity	1	50	-	-	-	-	-	-
Other	1	1	-	-	-	-	-	-
Total consumer loans	2	51	-	-	-	-	-	-
Total delinquent loans	11	$1,342	22	$2,536	3	$492	16	$2,795

Classified Assets. Management of the Bank, including the Managed Asset Committee, consisting of a number of the Bank's officers, review and classify the assets of the Bank on a monthly basis and the Board of Directors reviews the results of the reports on a quarterly basis. Federal regulations and the Bank's internal policies require that management utilize an internal asset classification system to monitor and evaluate the credit risk inherent in its loan portfolio. In addition, the Office of Thrift Supervision (the “OTS”) has the authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets; substandard, doubtful and loss. “Substandard assets” must have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. “Doubtful assets” have all the weaknesses inherent in those classified as “substandard” with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high probability of loss. Assets classified as “loss” are those assets considered uncollectible and of such little value that continuance as assets of the institution are not warranted. The regulations also provide for a “special mention” category, described as assets which do not currently expose us to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weakness deserving close attention. If the Bank classifies an asset as a loss, a loan loss allowance in the amount of 100% of the portion of the asset classified as a loss is established.

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The following table shows the aggregate amounts of the Bank's criticized and classified assets as of December 31, 2010.

(In Thousands)	Loss	Doubtful	Substandard	Special Mention
Real estate loans:				
Residential - 1 to 4 family	$ -	$ -	$ 3,066	$ 834
Multi-family and commercial	-	-	9,271	16,260
Construction	-	-	82	366
Total real estate loans	-	-	12,419	17,460
Commercial business loans:				
USDA and SBA guaranteed				