

SP Bancorp, Inc.
Form 10-K
March 29, 2011

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K**

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

For the fiscal ended December 31, 2010.

OR

**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: 001-34933

SP BANCORP, INC.

(Exact name of registrant as specified in its charter)

Maryland

27-3347359

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification Number)

5224 West Plano Parkway, Plano Texas

75093

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(972) 931-5311**

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

Common Stock, par value \$0.01 per share

The NASDAQ Stock Market LLC

(Title of each class to be registered)

(Name of each exchange on which
each class is to be registered)

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 ☒

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 ☒

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 website, 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 ☐ NO ☒

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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. ☒

Edgar Filing: SP Bancorp, Inc. - Form 10-K

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 ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ☐ NO ☐
There was no outstanding voting common equity of the Registrant as of June 30, 2010. 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 sale price on March 22, 2011, as reported by the Nasdaq Stock Market, was approximately \$16.4 million.
As of March 22, 2011, there was issued and outstanding 1,725,000 shares of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

(1) Proxy Statement for the 2011 Annual Meeting of Stockholders of the Registrant (Part III).

TABLE OF CONTENTS

<u>ITEM 1. BUSINESS</u>	1
<u>ITEM 1A. RISK FACTORS</u>	41
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS</u>	41
<u>ITEM 2. PROPERTIES</u>	41
<u>ITEM 3. LEGAL PROCEEDINGS</u>	41
<u>ITEM 4. RESERVED</u>	41
<u>ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	42
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	43
<u>ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	43
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	59
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	59
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	59
<u>ITEM 9A.(T) CONTROLS AND PROCEDURES</u>	59
<u>ITEM 9B. OTHER INFORMATION</u>	60
<u>ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	61
<u>ITEM 11. EXECUTIVE COMPENSATION</u>	61
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	61
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE</u>	62
<u>ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	62
<u>ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u>	63
<u>CONSOLIDATED FINANCIAL STATEMENTS</u>	F-1

Exhibit 21
Exhibit 31.1
Exhibit 31.2
Exhibit 32.1

Table of Contents

PART I

ITEM 1. Business

This Annual Report contains forward-looking statements, which can be identified by the use of words such as estimate, project, believe, intend, anticipate, plan, seek, expect, will, may and words of similar meaning. Forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the asset quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Annual Report.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

- general economic conditions, either nationally or in our market areas, that are worse than expected;
 - competition among depository and other financial institutions;
 - changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
 - adverse changes in the securities markets;
 - changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
 - our ability to enter new markets successfully and capitalize on growth opportunities;
 - our ability to successfully integrate acquired entities, if any;
 - changes in consumer and business spending, borrowing and savings habits;
 - changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;
 - changes in our organization, compensation and benefit plans;
-

Table of Contents

changes in our financial condition or results of operations that reduce capital; and
changes in the financial condition or future prospects of issuers of securities that we own.

Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

SP Bancorp, Inc.

SP Bancorp, Inc. (sometimes referred to herein as we or us) was incorporated as a Maryland corporation on June 16, 2010 and owns all of the outstanding shares of common stock of SharePlus Federal Bank as a result of the conversion from mutual to stock form of SharePlus Federal Bank on October 29, 2010. In the offering, SP Bancorp, Inc. issued a total of 1,725,000 shares of its common stock for an aggregate of \$17.25 million in total offering proceeds.

SP Bancorp, Inc. has not engaged in any business to date other than owning the common stock of SharePlus Federal Bank.

As of December 31, 2010, we had \$238.8 million of total assets, \$194.7 million of loans, net, including loans held for sale, \$188.2 million of deposits and \$32.1 million of total stockholders' equity on a consolidated basis.

Information in this Annual Report on Form 10-K prior to the completion of our initial public offering on October 29, 2010, including consolidated financial data presented as of and for the years ended December 31, 2009 and earlier, refers to SharePlus Federal Bank.

Our executive offices are located at 5224 W. Plano Parkway, Plano, Texas 75093. Our telephone number at this address is (972) 931-5311. Our website address is www.shareplus.com. Information on our website is not incorporated into this Annual Report and should not be considered part of this Annual Report.

SharePlus Federal Bank

SharePlus Federal Bank is a federally chartered savings bank headquartered in Plano, Texas. SharePlus Federal Bank was originally chartered in 1958 as a federal credit union serving the employees and family members of Frito-Lay, Inc. Over the years and through a series of mergers, the credit union also grew to serve the employees and family members of YUM! Brands, Inc., A&W Restaurants, Inc., KFC Corporation, Long John Silvers, Inc., Pizza Hut, Inc., Taco Bell Corp., and various PepsiCo divisions, as well as dozens of other companies that provided credit union benefits to their employees. Throughout this Annual Report on Form 10-K, these companies are sometimes referred to as our former sponsor companies.

We converted to a federal savings bank on October 1, 2004. The objective of the charter conversion was to implement our business strategy of broadening our banking services into residential mortgage lending as well as commercial real estate and commercial business lending. This has allowed us to better serve the needs of our customers and the local communities in which we operate, compete more effectively with other financial service providers, and have access to the capital markets through a potential stock offering.

Table of Contents

We provide financial services to individuals, families and businesses through our seven banking offices. Four of our branch offices are located in and around our headquarters in Plano, Texas. Additionally, two of our branches are located in Louisville, Kentucky and one is located in Irvine, California. Five of our seven branch offices are located within corporate facilities of our former sponsor companies. Because of their location within corporate offices, the substantial majority of the customers of these branches are employees of these former sponsor companies. During the first quarter of 2011, one of our Dallas branch offices located in a former sponsor company facility relocated to Plano, Texas. Upon the relocation, we converted this branch from a full-service office to an administrative office.

Our business consists primarily of taking deposits from the general public and investing those deposits, together with funds generated from operations and borrowings, in mortgage loans secured by residential real estate, home equity loans and lines of credit, commercial real estate loans, consumer loans (consisting primarily of automobile loans) and commercial business loans. At December 31, 2010, \$173.2 million, or 88.3%, of our total loan portfolio was comprised of residential and commercial real estate loans. We also offer brokerage services for the purchase and sale of non-deposit investment and insurance products through a third-party brokerage arrangement.

The majority of our residential and commercial real estate loans is originated through our Texas branch network and is collateralized by properties within this market area. Additionally, we are a preferred lender through various employee and executive relocation loan programs for certain of our former sponsor companies. Through these programs, we have the opportunity to provide loans on the primary residences of employees and executives who are being relocated by these companies, which resulted in a portion of our residential real estate loan portfolio being collateralized by properties outside of our Texas market area.

We also invest in investment securities, primarily consisting of government sponsored mortgage-backed securities and collateralized mortgage obligations guaranteed by Fannie Mae and Freddie Mac, and to a lesser extent, municipal obligations and agency bonds.

We offer a variety of deposit accounts, including noninterest-bearing and interest-bearing demand accounts, savings accounts, money market accounts and certificates of deposit.

SharePlus Federal Bank's executive offices are located at 5224 W. Plano Parkway, Plano, Texas 75093. Our telephone number at this address is (972) 931-5311. Our website address is www.shareplus.com. Information on our website is not incorporated into this Annual Report and should not be considered part of this Annual Report.

Market Area

Dallas-Fort Worth Metroplex

Our primary market area includes the cities of Plano and Dallas and Collin County and Dallas County and adjacent communities in the Dallas-Fort Worth-Arlington metropolitan statistical area (MSA). This region is also known as the Dallas-Fort Worth Metroplex (or DFW) and encompasses 12 counties in North Texas: Collin, Dallas, Delta, Denton, Ellis, Hunt, Johnson, Kaufman, Parker, Rockwall, Tarrant, and Wise Counties. The city of Plano is an affluent suburb, north of Dallas and is the ninth largest city in the state.

In 2005, Plano was designated as the best place to live in the Western United States by CNN Money magazine. In 2006, Plano was selected as the 11th best place to live in the United States by CNN Money magazine. Plano has been rated as the wealthiest city in the United States by CNN Money. In 2008, Forbes.com selected Plano as one of the three Top Suburbs to Live Well of Dallas. The United States Census Bureau declared Plano the wealthiest city of 2008 by comparing the median household income for all U.S. cities whose populations were greater than 250,000.

Table of Contents

Plano is the corporate headquarters for some of the country's largest and most recognized companies with the following companies having their headquarters (or major regional offices) in Plano: Adams Golf, Capital One Auto Finance, Dr Pepper Snapple Group (formerly Cadbury Schweppes Americas Beverages), Cinemark Theatres, HP Enterprise Services, Frito Lay, J.C. Penney, Dell Perot Systems and Rent-A-Center.

The total area of the DFW Metroplex contains 9,103 square miles. Its size makes it larger than the area of Rhode Island and Connecticut combined. The DFW Metroplex produces approximately 32% of the Texas gross state product. The population of the DFW Metroplex was estimated at 6.5 million in 2010 and is projected to grow by 10.1% over the five-year period from 2010 to 2015. The population expansion in the DFW Metroplex exceeded the national and state population growth rates from 2000 to 2010 and is expected to continue to sustain this trend. The population in Collin County was estimated at approximately 810,069 in 2010 and has experienced significant growth in recent years. The Collin County population increased by 64.8% in the 2000 to 2010 period and is projected to increase by 18.5% in the 2010 to 2015 period. The median age in the DFW Metroplex at 33.5 years was younger than the national median of 37.0 years and comparable to the state median of 33.7 years.

The median household income in the DFW Metroplex was \$63,064 in 2010 which exceeded the national and state medians of \$54,442 and \$51,960, respectively. The median household income in Collin County and the city of Plano was \$96,146 and \$105,329, respectively. The percentage of households with incomes of greater than \$100,000 was 24.7% in the DFW Metroplex and 48.5% in Collin County, compared to 18.8% for the United States and 18.0% for Texas. The concentration of higher household incomes in the DFW Metroplex is attributable partially to its diverse economic base and greater employment in white collar industry sectors.

In addition to serving the DFW Metroplex, we also serve retail customers (primarily employees of our former sponsor companies) through branches that are located in corporate facilities of our former sponsor companies in Louisville, Kentucky and Irvine, California.

Irvine, California

Irvine is located in Orange County, California which was developed in the 1960s as a planned community.

In 2010, the population of Irvine was estimated at 194,000 and is projected to grow by 7.5% over the next five-year period. From 2000 through the end of 2009, the population expansion in Irvine exceeded the national and state population growth rates. With a median age of 35.2 years, Irvine was younger than the national median of 37.0 years and comparable to the California state median of 34.4 years.

The median household income in Irvine was \$96,801 in 2010 and positioned above the national and state medians of \$54,442 and \$60,992, respectively. The percentage of households with incomes of greater than \$100,000 was 48.4% in Irvine, compared to 18.8% for the United States and 25.3% for California.

Table of Contents

Irvine is home to several universities including the University of California, Irvine, as well as a number of corporations, particularly in the technology and semiconductor sectors.

Louisville, Kentucky

Louisville is the largest city in the state of Kentucky, and the county seat of Jefferson County, which is situated on the Ohio River in north-central Kentucky.

The population of Louisville was estimated at 250,000 in 2010 and is projected to remain relatively flat over the five-year period from 2010 to 2015. In 2010, the median age in Louisville was 37.8 years, similar to the national median of 37.0 years and the Kentucky state median of 38.2 years.

The median household income in Louisville was \$37,929 in 2010 and positioned below the national and state medians of \$54,442 and \$43,765, respectively. The percentage of households with incomes of greater than \$100,000 was 9.7%, compared to 18.8% for the United States and 11.7% for Kentucky.

Louisville is home to the University of Louisville and many major corporations and organizations.

Competition

We face intense competition in our market area both in making loans and attracting deposits. We compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies and investment banking firms. Some of our competitors have greater name recognition and market presence that benefit them in attracting business, and offer certain services that we do not or cannot provide. Our deposit sources are primarily concentrated in the communities surrounding our banking offices, located in the Dallas-Fort Worth Metroplex and surrounding communities in North Texas. As of June 30, 2010, we ranked 24th in FDIC-insured deposit market share (out of 181 bank and thrift institutions with offices in the Dallas-Fort Worth-Arlington, Texas, MSA) with a 0.52% market share. Such data does not reflect deposits held by credit unions.

Lending Activities

Our principal lending activity is the origination of residential mortgage loans secured by residential real estate, commercial real estate and home equity loans, including lines of credit and home improvement loans, consumer loans (consisting primarily of automobile loans) and commercial business loans. The following table provides a historical breakdown of our loan portfolio at the end of each of our last five fiscal years.

Table of Contents

Loan Portfolio Composition. The following table sets forth the composition of our loan portfolio, including loans held for sale, by type of loan at the dates indicated.

	2010		2009		At December 31, 2008		2007		2006	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
Mortgage loans:										
One- to four-family residential	\$ 143,929	73.38%	\$ 125,418	72.96%	\$ 116,813	70.87%	\$ 95,852	69.71%	\$ 97,175	68.15%
Home equity ⁽¹⁾	10,112	5.15%	8,996	5.23	9,051	5.49	7,889	5.74	8,706	6.11
Commercial real estate	29,303	14.94%	22,615	13.16	17,498	10.62	5,551	4.04		
Consumer loans:										
Automobile and other vehicles	7,195	3.67%	9,892	5.75	15,525	9.42	22,618	16.45	30,551	21.42
Signature ⁽²⁾	1,806	0.92%	2,072	1.21	2,533	1.54	2,559	1.86	3,403	2.39
Other ⁽³⁾	1,334	0.68%	1,536	0.89	2,176	1.32	2,181	1.59	2,755	1.93
Commercial business loans	2,473	1.26%	1,369	0.80	1,225	0.74	848	0.61		
Total loans	\$ 196,152	100.00%	\$ 171,898	100.00%	\$ 164,821	100.00%	\$ 137,498	100.00%	\$ 142,590	100.00%
Other items:										
Premiums on mortgage pools ⁽⁴⁾	106		51		76		95		140	
Deferred loan origination costs, net	532		458		515		550		684	
Allowance for loan losses	(2,136)		(940)		(480)		(380)		(785)	
Total loans, net	\$ 194,654		\$ 171,467		\$ 164,932		\$ 137,763		\$ 142,629	

- (1) Includes home equity loans, home equity lines of credit and home improvement loans.
- (2) Signature loans are unsecured.
- (3) Includes loans on recreational vehicles, boats, certificate of deposit and other securities and other secured loans.
- (4) Represents the premium over par value paid for purchased loans. The premium is amortized on a monthly basis as an adjustment to yield.

Table of Contents

Loan Portfolio Maturities and Yields. 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		Home equity		Commercial real estate		Automobile and other vehicles	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in thousands)								
Due During the Years Ending December 31,								
2011	\$ 8,435	4.15%	\$ 7	7.80%	\$ 5,855	6.59%	\$ 502	6.53%
2012	288	6.25%	58	7.29%	5,112	7.68%	1,362	6.98%
2013	5	7.82%	179	6.37%	4,944	6.54%	1,588	6.52%
2014 to 2015	1,730	4.84%	467	6.34%	6,126	5.94%	3,187	5.66%
2016 to 2020	4,834	6.18%	1,976	6.73%	7,090	6.07%	542	5.64%
2021 to 2025	10,239	5.90%	2,327	7.29%			9	5.99%
2026 and beyond	118,398	5.18%	5,098	4.56%	176	6.51%	5	7.48%
Total	\$ 143,929	5.20%	\$ 10,112	5.74%	\$ 29,303	6.51%	\$ 7,195	6.16%

	Signature		Other		Commercial business loans		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in thousands)								
Due During the Years Ending December 31,								
2011	\$ 82	7.89%	\$ 352	5.07%	\$ 1,395	5.77%	\$ 16,628	5.26%
2012	218	12.34%	63	5.67%	268	6.75%	7,369	7.58%
2013	252	11.66%	175	7.11%	190	6.00%	7,333	6.71%
2014 to 2015	183	12.15%	354	6.35%	620	6.84%	12,667	5.88%
2016 to 2020	9	8.75%	177	5.90%			14,628	6.18%
2021 to 2025	39	9.10%	13	10.00%			12,627	6.17%
2026 and beyond	1,023	10.92%	200	5.75%			124,900	5.20%
Total	\$ 1,806	11.13%	\$ 1,334	5.97%	\$ 2,473	6.16%	\$ 196,152	5.53%

Table of Contents

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at December 31, 2010 that are contractually due after December 31, 2011.

	Due After December 31, 2011		
	Fixed	Adjustable	Total
	(In thousands)		
Mortgage loans:			
One- to four-family residential	\$ 46,546	\$ 88,948	\$ 135,494
Home equity	4,861	5,244	10,105
Commercial real estate	16,197	7,251	23,448
Consumer loans:			
Automobile and other vehicles	6,693		6,693
Signature	1,557	167	1,724
Other	982		982
Commercial loans		1,078	1,078
Total loans	\$ 76,836	\$ 102,688	\$ 179,524

One- to Four-Family Residential Mortgage Loans. At December 31, 2010, \$143.9 million, or 73.4% of our total loan portfolio, consisted of one- to four-family residential mortgage loans. We offer residential mortgage loans that conform to Fannie Mae, Freddie Mac, Federal Housing Administration (FHA) and Department of Veterans Affairs (VA) underwriting standards (conforming loans) and non-conforming loans. We generally underwrite our one- to four-family residential mortgage loans based on the applicant's employment and credit history and the appraised value of the subject property. Our loans have fixed-rates and adjustable-rates, with maturities of up to 30 years, and maximum loan amounts generally up to \$1.0 million. As of December 31, 2010, we had 24 one- to four-family residential mortgage loans with balances greater than \$1.0 million. At December 31, 2010, fixed-rate one- to four-family residential mortgage loans totaled \$54.6 million and adjustable-rate one- to four-family residential mortgage loans totaled \$89.3 million.

We currently offer fixed-rate conventional mortgage loans with terms of up to 30 years that are fully amortizing with monthly loan payments, and adjustable-rate mortgage loans that generally provide an initial fixed interest rate for three, five, seven or ten years and that amortize over a period up to 30 years. We do not offer discounted or lower introductory (teaser) rates on our adjustable-rate mortgage loans.

Our one- to four-family residential mortgage loans are generally conforming loans, underwritten according to Fannie Mae, Freddie Mac, FHA and VA guidelines. We generally originate both fixed- and adjustable-rate mortgage loans in amounts up to the maximum conforming loan limits as established by the Federal Housing Finance Agency, which is currently \$417,000 for single-family homes in most markets. However, it is not uncommon for single-family houses in parts of our Collin County and Dallas County market areas to have market prices well in excess of this amount. At December 31, 2010, we had 58 one- to four-family residential mortgage loans that had principal balances in excess of \$750,000. At that date, our average one- to four-family residential mortgage loan had a principal balance of \$267,000. We also originate loans above the lending limit for conforming loans, which we refer to as jumbo loans. We typically originate adjustable-rate jumbo loans with an initial fixed-rate period of three, five, seven or ten years and which then adjust annually thereafter. Additionally, on occasion we will originate fixed-rate jumbo loans with terms of up to 30 years. At December 31, 2010, our largest one- to four-family residential mortgage loan had an outstanding balance of \$2.2 million, was secured by a single family residence in Dallas, Texas, and was performing in accordance with its terms.

We will originate first-lien mortgage loans with loan-to-value ratios in excess of 80%, provided that, with limited exceptions, the borrower obtains private mortgage insurance. We generally will not originate loans with a loan-to-value ratio in excess of 90%. On occasion we will originate a first-lien mortgage loan with a loan-to-value of

80% with a second-lien loan for an additional 10% loan-to-value with no private mortgage insurance. As of December 31, 2010, \$3.5 million, or 2.4%, of our residential loan portfolio had loan-to-value ratios in excess of 90% without private mortgage insurance. These loans are reviewed quarterly by management and reported to the Board.

Table of Contents

We actively monitor our interest rate risk position to determine the desirable level of investment in fixed-rate mortgages. Generally, we retain in our portfolio fixed-rate one- to four-family residential mortgage loans with terms of less than 15 years. We currently sell into the secondary mortgage market most of our long-term, fixed-rate one- to four-family residential mortgage loans with terms of 15 years or greater. Such loans are sold on a servicing-released basis without recourse but with early-payment default provisions (generally, if one of the first three or four payments becomes 90 days or more past-due, depending on the investor). No loans were required to be repurchased during 2009 or 2010. We will retain in our portfolio a small percentage of these long-term, fixed-rate loans if we determine that doing so is warranted due to the customer relationship.

We currently offer several types of adjustable-rate mortgage loans secured by residential properties with interest rates that are fixed for an initial period ranging from three to ten years. We offer adjustable-rate mortgage loans that are fully amortizing. After the initial fixed period, the interest rate on adjustable-rate mortgage loans is generally reset every year based upon a contractual spread or margin above the average yield on the London Interbank Offered Rate (LIBOR), adjusted to a constant maturity of one year, as published weekly by the Federal Reserve Board, subject to periodic and lifetime limitations on interest rate changes. Generally the initial change in interest rates on our adjustable-rate mortgage loans cannot exceed two percentage points, subsequent interest rate changes cannot exceed two percentage points and total interest rate changes cannot exceed six percentage points over the life of the loan. Adjustable-rate mortgage loans generally present different credit risks than fixed-rate mortgage loans, primarily because the underlying debt service payments of the borrowers increase as interest rates increase, thereby increasing the potential for default and higher rates of delinquency. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Since changes in the interest rates on adjustable-rate mortgages may be limited by an initial fixed-rate period or by the contractual limits on periodic interest rate adjustments, adjustable-rate loans may not adjust as quickly to increases in interest rates as our interest-bearing liabilities.

We do not offer or purchase loans that provide for negative amortization of principal, such as Option ARM loans, where the borrower can pay less than the interest owed on the loan, resulting in an increased principal balance during the life of the loan.

We require title insurance on all of our one- to four-family residential mortgage loans that exceed \$100,000, and we also require that borrowers maintain fire and extended coverage casualty insurance (and, if appropriate, flood insurance) in an amount at least equal to the lesser of the loan balance or the replacement cost of the improvements. We do not conduct environmental testing on residential mortgage loans unless specific concerns for hazards are identified by the appraiser used in connection with the origination of the loan.

At December 31, 2010, we had no foreclosures secured by one- to four-family residences.

Home Equity Loans and Lines of Credit. In addition to traditional one- to four-family residential mortgage loans, we offer home equity loans and home equity lines of credit that are secured by the borrower's primary residence. Our home equity loans are primarily originated with fixed rates of interest with terms of up to 15 years. Home equity loans and lines of credit are generally underwritten using the same criteria that we use to underwrite one- to four-family residential mortgage loans. Home equity loans may be underwritten with a loan-to-value ratio of 80% when combined with the principal balance of the existing mortgage loan.

Table of Contents

Home equity lines of credit are generally originated as revolving lines with adjustable-rates of interest. At December 31, 2010, the outstanding balance of revolving home equity lines of credit totaled \$5.2 million, or 2.6% of our total loan portfolio, and the outstanding balance of term home equity loans totaled \$4.9 million, or 2.5% of our total loan portfolio.

Home equity loans secured by second mortgages have greater risk than residential mortgage loans secured by first mortgages. We face the risk that the collateral will be insufficient to compensate us for loan losses and costs of foreclosure. When customers default on their loans, we attempt to foreclose on the property and resell the property as soon as possible to minimize foreclosure and carrying costs. However, the value of the collateral may not be sufficient to compensate us for the amount of the unpaid loan and we may be unsuccessful in recovering the remaining balance from those customers. Particularly with respect to our home equity loans, decreases in real estate values could adversely affect the value of property used as collateral for our loans.

Commercial Real Estate Loans. We originate commercial real estate loans secured primarily by office buildings, retail centers, owner-occupied offices, condominiums, developed lots and land. Loans secured by commercial real estate totaled \$29.3 million, or 14.9% of our total loan portfolio, at December 31, 2010, and consisted of 34 loans outstanding with an average loan balance of approximately \$862,000. Commercial real estate loans that we originate are secured by properties located in Texas. We do not actively pursue commercial lending opportunities in our Louisville, Kentucky and Irvine, California market areas, but will consider commercial business loan requests from existing customers in these areas.

Our commercial real estate loans are generally written for terms of up to five years with a 20 year amortization schedule. The rates are generally tied to the prime interest rate as reported in *The Wall Street Journal* and generally have a specified minimum (floor) rate. Many of our adjustable-rate commercial real estate loans are not fully amortizing, and therefore require a single balloon payment at maturity. We also originate three to five year adjustable rate, fully amortizing commercial real estate loans. A portion of our commercial real estate loans are loans where we have provided permanent financing for borrowers following the completion of construction for which we previously provided construction financing.

In underwriting commercial real estate loans, we generally lend up to 80% of the property's appraised value and up to 65% of the property's appraised value if the property is undeveloped or unimproved land. We base our decisions to lend on the economic viability of the property and the creditworthiness of the borrower. In evaluating a proposed commercial real e