

FSB Community Bankshares Inc
Form 10KSB
March 31, 2008

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

FORM 10-KSB

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2007

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: 001- 52751

FSB Community Bankshares, Inc.
(Exact Name of Registrant as Specified in its Charter)

United States
(State or Other Jurisdiction of Incorporation or Organization)

74-3164710
(I.R.S. Employer Identification No.)

45 South Main Street, Fairport, New York
(Address of Principal Executive Offices)

14450
(Zip Code)

(585) 223-9080
(Issuer's Telephone Number including area code)

Securities Registered Pursuant to Section 12(b) of the Act:
None

Title of Class	Name of Each Exchange On Which Registered
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Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, par value \$0.10 per share

Check whether the Issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

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Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such requirements for the past 90 days.

1. YES NO
2. YES NO

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB.

Indicate by check mark whether the Registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act.)

YES NO

State Issuer's revenues for its most recent fiscal year: \$9.2 million

The aggregate value of the voting stock held by non-affiliates of the Registrant, computed by reference to the closing price of the common stock on March 27, 2008 (\$7.35 per share) was \$6.15 million.

As of March 27, 2008, there were 1,785,000 shares of the Registrant's common stock, par value \$0.10 per share, outstanding, of which 946,050 shares, or 53%, were held by FSB Community Bankshares, MHC, the Registrant's mutual holding company.

DOCUMENTS INCORPORATED BY REFERENCE

1. Proxy Statement for the 2008 Annual Meeting of Stockholders (Parts II and III).
2. Annual Report to Shareholders for the year ended December 31, 2007 (Part II).

Transitional Small Business Disclosure Format: YES NO

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Forward-Looking Statements

This Annual Report contains certain “forward-looking statements” which may be identified by the use of words such as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates and most other statements that are not historical in nature. These factors include, but are not limited to, general and local economic conditions, changes in interest rates, deposit flows, demand for mortgage, commercial and other loans, real estate values, competition, changes in accounting principles, policies, or guidelines, changes in legislation or regulation, and other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing products and services.

FSB Community Bankshares, MHC

FSB Community Bankshares, MHC is a federally chartered mutual holding company and currently owns 53% of the outstanding common stock of FSB Community Bankshares, Inc. FSB Community Bankshares, MHC has not engaged in any significant business other than owning the common stock of FSB Community Bankshares, Inc. So long as FSB Community Bankshares, MHC exists, it is required to own a majority of the voting stock of FSB Community Bankshares, Inc. The executive office of FSB Community Bankshares, MHC is located at 45 S. Main Street, Fairport, New York 14450, and its telephone number is (585) 223-9080. FSB Community Bankshares, MHC is subject to comprehensive regulation and examination by the Office of Thrift Supervision.

FSB Community Bankshares, Inc.

FSB Community Bankshares, Inc. is a federally chartered mid-tier stock holding company of Fairport Savings Bank. FSB Community Bankshares, Inc. owns 100% of the common stock of Fairport Savings Bank and has approximately \$3.0 million in investment securities. FSB Community Bankshares, Inc. has not engaged in any significant business activity other than owning the common stock of Fairport Savings Bank and \$3.0 million in investment securities, and currently does not intend to expand materially its business activities, other than through its ownership of Fairport Savings Bank (the “Bank”).

FSB Community Bankshares, Inc. completed its initial public offering on August 10, 2007 by selling 838,950 shares, or 47.0% of our outstanding common stock, at a price of \$10.00 per share, to the Bank’s eligible depositors, the Bank’s employee stock ownership plan and the public. Additionally, we issued 946,050 shares, or 53.0% of our common stock, to FSB Community Bankshares, MHC our federally chartered mutual holding company parent.

At December 31, 2007, we had total consolidated assets of \$167.6 million, total deposits of \$119.2 million and stockholders’ equity of \$20.1 million. Our consolidated net loss for the year ended December 31, 2007 was \$281,000.

Our executive offices and the Bank’s executive offices are located at 45 South Main Street, Fairport, New York 14450, and our telephone number is (585) 223-9080.

Our website address is www.fairportsavingsbank.com. Information on our website is not and should not be considered a part of this Annual Report on Form 10-KSB.

Fairport Savings Bank

Fairport Savings Bank is a federally chartered savings bank headquartered in Fairport, New York and was originally founded in 1888. Fairport Savings Bank conducts business from its main office in Fairport, New York and two branches located in Penfield, New York which opened in 2003 and Irondequoit, New York, which opened in January 2007. The telephone number at its main office is (585) 223-9080. Fairport Savings Bank is subject to comprehensive regulation and examination by the OTS.

Our principal business consists of originating one- to four-family residential real estate mortgage loans and home equity lines of credit, and to a lesser extent, originations of commercial real estate, multi-family, construction and other consumer loans. We attract retail deposits from the general public in the areas surrounding our main office and our branch offices. We offer our customers a variety of deposit products with interest rates that are competitive with those of similar products offered by other financial institutions in our market area. We retain substantially all of the loans that we originate. Loans that we sell consist of long-term, fixed-rate residential real estate mortgage loans. We retain the servicing rights on all loans that we sell. Our loans are sold without recourse. We have not entered into loan participations in recent years. Our revenues are derived primarily from interest on loans and, to a lesser extent, interest on investment securities and mortgage-backed securities. We also generate revenues from fees and service charges. Our primary sources of funds are deposits, borrowings, and principal and interest payments on loans and securities. Additionally, we derive a portion of our non-interest income through Oakleaf Services Corporation, our subsidiary that offers non-deposit investments such as annuities, insurance products and mutual funds.

Market Area

Fairport Savings Bank considers its market area to consist of Monroe County, New York, and to a lesser extent, the surrounding counties in Western New York. Monroe County is a suburban market dominated by the City of Rochester, the third largest city in the State of New York. In 2006, Monroe County had a population of 746,000. The Monroe County economy is largely dependent on local businesses and institutions. The University of Rochester and Strong Memorial Hospital were two of the largest employers in the Rochester area in 2006. Rochester is also home to a number of international businesses, including Eastman Kodak, Bausch & Lomb, Constellation Brands and Paychex. Additionally, Xerox, while no longer headquartered in Rochester, has its principal offices and manufacturing facilities in Monroe County.

Competition

We face intense competition in our market areas both in making loans and attracting deposits. Our market areas have a high concentration of financial institutions, including large money center and regional banks, community banks and credit unions. We face additional competition for deposits from money market funds, brokerage firms, mutual funds and insurance companies. Some of our competitors offer products and services that we currently do not offer, such as commercial business loans, trust services and private banking.

The majority of our depositors live and/or work in Monroe County, New York. At June 30, 2007, the latest date for which information is available through the Federal Deposit Insurance Corporation, we held approximately 1.3% of the thrift and bank deposits available in Monroe County.

Our primary strategy for increasing and retaining our customer base is to offer competitive deposit and loan rates and product features, delivered with exceptional customer service. Our primary focus is to build and develop profitable customer relationships across all lines of business while maintaining our role as a community bank.

Lending Activities

Our principal lending activity is the origination of first mortgage loans to purchase or refinance one- to four-family residential real estate. We also originate a significant number of home equity lines of credit and, to a lesser extent, multi-family residential, construction, commercial real estate and other loans (consisting of automobile, passbook, overdraft protection and unsecured loans). At December 31, 2007, one- to four-family residential real estate mortgage loans totaled \$113.3 million, or 91.2% of our loan portfolio, home equity lines of credit totaled \$6.6 million, or 5.3% of our loan portfolio, commercial real estate loans totaled \$2.1 million or 1.7% of our loan portfolio, and other loans totaled \$2.2 million or 1.8% of our loan portfolio.

Our strategic plan continues to focus on residential real estate lending, whereby a portion of fixed-rate long term residential loan originations will be sold, on a servicing retained basis, to increase non-interest income, and the remaining loans will be added to our loan portfolio for interest earning income.

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

	At December 31,			
	2007		2006	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Real estate loans:				
One- to four-family residential(1)	\$ 113,267	91.2%	\$ 109,786	90.6%
Home equity lines of credit	6,622	5.3	6,929	5.7
Multi-family residential	918	0.7	1,040	0.9
Construction(2)	1,114	0.9	380	0.3
Commercial	2,123	1.7	2,745	2.3
Other loans	200	0.2	241	0.2
Total loans receivable	124,244	100.0%	121,121	100.0%
Deferred loan costs	401		338	
Allowance for loan losses	(319)		(322)	
Total loans receivable, net	\$ 124,326		\$ 121,137	

(1) Includes \$4.7 million and \$3.9 million of closed-end home equity loans at December 31, 2007 and 2006, respectively.

(2) Represents amounts disbursed at December 31, 2007 and 2006.

Loan Portfolio Maturities. The following table summarizes the scheduled repayments of our gross loan portfolio at December 31, 2007. Demand loans, loans having no stated repayment schedule or maturity, and overdraft loans are reported as being due in the year ending December 31, 2008. Maturities are based on the final contractual payment date and do not reflect the impact of prepayments and scheduled principal amortization.

Due During the Years Ending December 31,	One-to- Four Family Residential Real Estate Loans	Home Equity Lines of Credit	Multi- Family Residential Real Estate Loans	Construction Loans	Commercial Real Estate Loans	Other Loans	Total
	(In thousands)						
2008	\$ 40	\$ —	\$ —	\$ —	151	\$ 39	\$ 230
2009	135	—	—	—	13	52	200
2010	192	—	—	—	144	39	375

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2011 to 2012	2,527	—	67	—	81	70	2,745
2013 to 2017	21,068	—	318	—	337	—	21,723
2018 to 2022	31,502	—	124	348	858	—	32,832
2023 and beyond	57,803	6,622	409	766	539	—	66,139
Total	\$ 113,267	\$ 6,622	\$ 918	\$ 1,114	\$ 2,123	\$ 200	\$ 124,244

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The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at December 31, 2007 that are contractually due after December 31, 2008.

	Due After December 31, 2008		
	Fixed	Adjustable	Total
	(In thousands)		
Real estate loans:			
One- to four-family residential	\$ 104,597	\$ 8,630	\$ 113,227
Home equity lines of credit	—	6,622	6,622
Multi-family residential	434	484	918
Construction	1,114	—	1,114
Commercial	802	1,170	1,972
Other loans	161	—	161
Total	\$ 107,108	\$ 16,906	\$ 124,014

One- to Four-Family Residential Real Estate Mortgage Loans. Our primary lending activity is the origination of one- to four-family residential real estate mortgage loans. At December 31, 2007, \$113.3 million, or 91.2% of our total loan portfolio, consisted of one- to four-family residential real estate mortgage loans. We offer conforming and non-conforming, fixed-rate and adjustable-rate residential real estate mortgage loans with maturities of up to 30 years and maximum loan amounts generally of up to \$750,000.

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 provide an initial fixed interest rate for one, three, five, seven or ten years and that amortize over a period of up to 30 years. We originate fixed-rate mortgage loans with terms of less than 15 years, but at rates applicable to our 15-year loans. We originate fixed-rate bi-weekly mortgage loans with terms of up to 30 years that are fully amortizing with bi-weekly loan payments. We also offer “interest only” loans, where the borrower pays interest for an initial period (ten years), after which the loan converts to a fully amortizing loan.

One- to four-family residential real estate mortgage loans are generally underwritten according to Freddie Mac guidelines, and we refer to loans that conform to such guidelines as “conforming loans.” We generally originate both fixed and adjustable-rate mortgage loans in amounts up to the maximum conforming loan limits as established by the Office of Federal Housing Enterprise Oversight, which at December 31, 2007 was \$417,000 for single-family homes. We also originate loans above the lending limit for conforming loans, which we refer to as “jumbo loans.” We generally underwrite jumbo loans in a manner similar to conforming loans generally with increased rates. These loans are generally eligible for sale to various firms that specialize in purchasing non-conforming loans. Jumbo loans are not uncommon in our market area. For first mortgage loans with loan-to-value ratios in excess of 80% we require private mortgage insurance.

As a result of our conservative underwriting standards, we believe that we do not have any loans in our loan portfolio that are considered sub-prime.

We actively monitor our interest rate risk position to determine the desirable level of investment in fixed-rate mortgages. Depending on market interest rates and our capital and liquidity position, we may retain all of our newly originated longer-term fixed-rate residential mortgage loans, or we may sell all or a portion of such loans in the secondary mortgage market to government sponsored entities such as Freddie Mac or other purchasers.

During periods of low market interest rates, we attempt to sell a portion of our newly originated fixed-rate residential real estate mortgage loans. Our ability to sell these fixed-rate loans has been constrained in recent periods by rising interest rates. During 2007, we sold \$1.0 million in loans. For the year ended December 31, 2007, we received servicing fees of \$5,000. As of December 31, 2007, the principal balance of loans serviced for others totaled \$2.8 million.

We currently offer several adjustable-rate mortgage loans secured by residential properties with interest rates that are fixed for an initial period ranging from one year to ten years. 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 U.S. Treasury securities, 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. All of our interest-only loans and our traditional adjustable-rate mortgage loans with initial fixed-rate periods of one, three, five, seven and ten years have initial and periodic caps of two percentage points on interest rate changes, with a cap of six percentage points for the life of the loan. Many of the borrowers who select these loans have shorter-term credit needs than those who select long-term, fixed-rate mortgage loans. We do not offer "Option ARM" loans, where borrowers can pay less than the interest owed on their loan, resulting in an increased principal balance during 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. Interest-only loans present different credit risks than fully amortizing loans, as the principal balance of the loan does not decrease during the interest-only period. As a result, our exposure to loss of principal in the event of default does not decrease during this period.

We generally require title insurance on all of our one- to four-family residential real estate mortgage loans, 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. For fixed-rate mortgage loans with terms of fifteen years or less, we will accept an attorney's letter in lieu of title insurance. A majority of our residential real estate mortgage loans have a mortgage escrow account from which disbursements are made for real estate taxes and flood insurance. We do not conduct environmental testing on residential real estate mortgage loans unless specific concerns for hazards are identified by the appraiser used in connection with the origination of the loan.

Home Equity Lines of Credit. We also offer home equity lines of credit, which are primarily secured by a second mortgage on one- to four-family residences. At December 31, 2007, home equity lines of credit totaled \$6.6 million, or 5.3% of total loans receivable. At this date we had an additional \$7.1 million of undisbursed home equity lines of credit.

The underwriting standards for home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations and payments on the proposed loan and the value of the collateral securing the loan. The combined loan-to-value ratio (first and second mortgage liens) for home equity lines of credit is generally limited to 90%. We originate our home equity lines of credit without application fees or borrower-paid closing costs. Our home equity lines of credit are offered with adjustable rates of interest indexed to the prime rate, as reported in *The Wall Street Journal*.

Multi-Family Residential Loans. Loans secured by multi-family real estate totaled approximately \$918,000, or 0.7%, of the total loan portfolio at December 31, 2007. Multi-family residential loans generally are secured by rental properties. All multi-family residential loans are secured by properties located within our lending area. At December 31, 2007, we had six multi-family loans with an average principal balance of \$153,000, and the largest multi-family real estate loan had a principal balance of \$409,000. All of our loans secured by multi-family real estate loans are performing in accordance with their terms. Multi-family real estate loans are offered with fixed and adjustable interest rates. Multi-family real estate loans are originated for terms of up to 20 years. Adjustable-rate multi-family real estate loans are tied to the average yield on U.S. Treasury securities, subject to periodic and lifetime limitations on interest rate changes.

We consider a number of factors in originating multi-family 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 mortgaged 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 debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service and the ratio of the loan amount to the appraised value of the mortgaged property. Multi-family real estate loans are originated in amounts up to 70% of the appraised value of the mortgaged property securing the loan. All multi-family loans are appraised by outside independent appraisers approved by the board of directors.

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

Construction Loans. We also originate construction loans for the purchase of developed lots and for the construction of single-family residences. Construction loans are offered to individuals for the construction of their personal residences by a qualified builder (construction/permanent loans). At December 31, 2007, construction loans totaled \$1.1 million, or 0.9% of total loans receivable. At December 31, 2007, the additional unadvanced portion of these construction loans totaled \$270,000.

Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We generally also review and inspect each property before disbursement of funds during the term of the construction loan.

Construction financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost proves to be inaccurate, we may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project proves to be inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment of the loan.

Commercial Real Estate Loans. At December 31, 2007, \$2.1 million, or 1.7% of our total loan portfolio consisted of commercial real estate loans. Commercial real estate loans are secured by office buildings, mixed use properties, places of worship and other commercial properties. We generally originate adjustable-rate commercial real estate loans with maximum terms of up to 15 years. The maximum loan-to-value ratio of commercial real estate loans is 70%. At December 31, 2007, we had 18 commercial real estate loans with an average outstanding balance of \$117,000. At December 31, 2007, our largest loan secured by commercial real estate consisted of a \$539,000 loan secured by an office building/warehouse. At December 31, 2007 this loan was performing in accordance with its terms. At December 31, 2007 all of our loans secured by commercial real estate were performing in accordance with their terms.

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 mortgaged 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 debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service, and the ratio of the loan amount to the appraised value of the mortgaged property. Commercial real estate loans are originated in amounts up to 70% of the appraised value of the mortgaged property securing the loan. All commercial loans are appraised by outside independent appraisers approved by the board of directors. Personal guarantees are generally obtained from commercial real estate borrowers.

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. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

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Other Loans. We offer a variety of loans secured by property other than real estate. These loans include automobile, passbook, overdraft protection and unsecured loans. At December 31, 2007, these other loans totaled \$200,000, or 0.2% of the total loan portfolio.

Loan Originations, Sales, and Servicing. Lending activities are conducted by our loan personnel operating at our main and branch office locations and through local mortgage brokers. All loans that we originate are underwritten pursuant to our policies and procedures, which incorporate Freddie Mac underwriting guidelines to the extent applicable. We originate both adjustable-rate and fixed-rate loans. Our ability to originate fixed or adjustable-rate loans is dependent upon the relative customer demand for such loans, which is affected by current market interest rates as well as anticipated future market interest rates. Our loan origination and sales activity may be adversely affected by a rising interest rate environment that typically results in decreased loan demand. Historically, a majority of our one- to four-family residential real estate mortgage loan originations have been generated by local mortgage brokers, as well as our in-house loan representatives. Loans obtained from brokers are underwritten and funded by us. We also obtain referrals from existing or past customers and by referrals from local builders, real estate brokers and attorneys.

We sell our loans without recourse. Historically, we have retained the servicing rights on all residential real estate mortgage loans that we have sold, and we intend to continue this practice in the future. At December 31, 2007, we were servicing loans owned by others with a principal balance of \$2.8 million. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, contacting delinquent borrowers, supervising foreclosures and property dispositions in the event of unremedied defaults, making certain insurance and tax payments on behalf of the borrowers and generally administering the loans. We retain a portion of the interest paid by the borrower on the loans we service as consideration for our servicing activities. We have not engaged in loan purchases or entered into loan participations in recent years.

The following table shows our loan originations, sales and repayment activities for the years indicated.

	For the year ended December	
	31,	
	2007	2006
	(In thousands)	
Total loans at beginning of period	\$ 121,121	\$ 108,601
Loan originations:		
Real estate loans:		
One-to four-family residential	19,198	22,721
Home equity lines of credit	1,431	2,295
M u l t i - f a m i l y residential	—	137
Construction	—	1,115
Commercial	—	—
Other loans	113	165
Total loans originated	20,742	26,433
Sales and loan principal repayments:		
Deduct:		
Principal repayments	16,605	12,734

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Loan sales	1,014	1,179
Net loan activity	3,123	12,520
Total loans at end of period	\$ 124,244	\$ 121,121

Loan Approval Policy and Authority. Fairport Savings Bank's lending activities follow written, non-discriminatory underwriting standards and loan origination policies approved by Fairport Savings Bank's board of directors. The loan approval process is intended to assess the borrower's ability to repay the loan and value of the property that will secure the loan. To assess the borrower's ability to repay, we review the borrower's employment and credit history and information on the historical and projected income and expenses of the borrower.

We generally require independent third-party appraisals of real property securing loans. Appraisals are performed by independent licensed appraisers. All appraisers are approved by the board of directors annually.

Loans to One Borrower. A federal savings bank generally may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned equal to 10% of unimpaired capital and surplus if the loan is secured by readily marketable collateral, which generally does not include real estate. Our loans to one borrower limit under this regulation is \$5.0 million (including the additional amount). Our policy provides that loans to one borrower (or related borrowers) should not exceed \$750,000. At December 31, 2007, we had two loans exceeding this amount, the largest of which totaled \$974,000 and was secured by the borrower's primary residence. This loan was performing in accordance with its terms. Our next largest lending relationship to one borrower at December 31, 2007 totaled \$898,000, and was secured by the borrower's primary residence. This loan was performing in accordance with its terms.

Non-Performing Assets and Delinquent Loans

System-generated late notices are mailed to borrowers after the late payment "grace period," which is 15 days in the case of all loans secured by real estate and 10 days in the case of other loans. A second notice will be mailed to borrowers if the loan remains past due after 30 days. When a loan is more than 60 days past due, we attempt to contact the borrower and develop a plan of repayment. By the 90th day of delinquency, we will have our attorneys issue a demand letter. The demand letter will require the borrowers to bring the loan current within 30 days in order to avoid the beginning of foreclosure proceedings for loans secured by real estate. With respect to automobile loans we will seek to repossess the vehicle if the loan is 90 days delinquent. A report of all loans 30 days or more past due is provided to the board of directors monthly.

Loans are generally placed on non-accrual status when payment of principal or interest is more than 90 days delinquent, unless the loans are well-secured and in the process of collection. Loans are also placed on non-accrual status if collection of principal or interest in full is in doubt or if the loan has been restructured. At December 31, 2007 and December 31, 2006, we had no restructured loans. When loans are placed on a non-accrual status, unpaid accrued interest is fully reversed, and further income is recognized only to the extent received. The loan may be returned to accrual status if unpaid principal and interest are repaid so that the loan is less than 90 days delinquent and a satisfactory payment history has been established. Loans not secured by real estate will be charged-off if they become 120 days past due.

Non-Performing Assets. The table below sets forth the amounts and categories of our non-performing assets at the dates indicated.

	At December 31,	
	2007	2006
	(Dollars in thousands)	
Non-accrual loans:		
Real estate loans:		
One- to four-family residential	\$ 63	\$ 143
Home equity lines of credit	—	28
Multi-family residential	—	—
Construction	—	—
Commercial		