

TF FINANCIAL CORP  
Form 10-Q  
November 14, 2013

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

FORM 10-Q

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

For the period ended September 30, 2013

- 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: 1-35163

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

Pennsylvania  
(State or Other Jurisdiction of Incorporation  
or Organization)

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

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

18940  
(Zip Code)

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

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: November 13, 2013

Class	Outstanding
\$.10 par value common stock	3,149,239 shares

CONTENTS

PART I-CONSOLIDATED FINANCIAL INFORMATION

Item 1.	<u>Consolidated Financial Statements (Unaudited)</u>	3
Item 2.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	40
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	49
Item 4.	<u>Controls and Procedures</u>	49

PART II-OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	50
Item 1A.	<u>Risk Factors</u>	50
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
Item 3.	<u>Defaults Upon Senior Securities</u>	50
Item 4.	<u>Mine Safety Disclosures</u>	50
Item 5.	<u>Other Information</u>	50
Item 6.	<u>Exhibits</u>	50

Signatures

Exhibits

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

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

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



Table of Contents

## TF FINANCIAL CORPORATION AND SUBSIDIARIES

## PART I-CONSOLIDATED FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2013	At December 31, 2012
	(in thousands)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 31,004	\$ 31,137
Investment securities		
Available for sale	129,074	102,284
Held to maturity (fair value of \$1,719 and \$2,271 as of September 30, 2013 and December 31, 2012, respectively)	1,540	1,965
Loans receivable, held for sale	691	706
Loans receivable, net of allowance of \$6,691 and \$6,922 at September 30, 2013 and December 31, 2012, respectively	622,330	526,720
Federal Home Loan Bank ("FHLB") stock — at cost	3,425	5,431
Accrued interest receivable	2,669	2,460
Premises and equipment, net	8,657	6,108
Goodwill	4,324	4,324
Core deposit intangible	528	—
Bank owned life insurance	18,451	19,109
Other assets	10,641	11,592
<b>TOTAL ASSETS</b>	<b>\$ 833,334</b>	<b>\$ 711,836</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Deposits	\$ 681,825	\$ 560,315
Advances from the FHLB	50,990	60,656
Advances from borrowers for taxes and insurance	2,344	2,880
Accrued interest payable	729	817
Other liabilities	4,635	4,223
<b>Total liabilities</b>	<b>740,523</b>	<b>628,891</b>
<b>Stockholders' equity</b>		
Preferred stock, no par value; 2,000,000 shares authorized at September 30, 2013 and December 31, 2012, none issued	—	—
Common stock, \$0.10 par value; 10,000,000 shares authorized, 5,290,000 shares issued, 3,147,902 and 2,838,493 shares outstanding at September 30, 2013 and December 31, 2012, respectively, net of shares in treasury of 2,142,098 and 2,451,507, respectively.	529	529
Additional paid-in capital	56,072	54,328

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Unearned ESOP shares	(877 )	(970 )
Treasury stock — at cost	(44,530 )	(50,896 )
Retained earnings	83,394	78,984
Accumulated other comprehensive (loss) income	(1,777 )	970
Total stockholders' equity	92,811	82,945
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 833,334</b>	<b>\$ 711,836</b>

The accompanying notes are an integral part of these statements

Table of Contents

## TF FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands, except per share data)			
Interest income				
Loans, including fees	\$6,947	\$6,436	\$18,976	\$18,864
Investment securities				
Fully taxable	540	544	1,264	1,840
Exempt from federal taxes	411	415	1,241	1,280
Interest-bearing deposits and other	5	—	23	2
<b>TOTAL INTEREST INCOME</b>	<b>7,903</b>	<b>7,395</b>	<b>21,504</b>	<b>21,986</b>
Interest expense				
Deposits	799	803	2,242	2,795
Borrowings	219	338	693	1,094
<b>TOTAL INTEREST EXPENSE</b>	<b>1,018</b>	<b>1,141</b>	<b>2,935</b>	<b>3,889</b>
<b>NET INTEREST INCOME</b>	<b>6,885</b>	<b>6,254</b>	<b>18,569</b>	<b>18,097</b>
Provision for loan losses	—	750	839	1,750
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>6,885</b>	<b>5,504</b>	<b>17,730</b>	<b>16,347</b>
Noninterest income				
Service fees, charges and other operating income	592	380	1,769	1,237
Earnings on bank owned life insurance	136	152	416	456
Bank owned life insurance death benefit proceeds	—	—	934	—
Gain on sale of loans	104	382	635	920
Gain on disposition of premises and equipment	—	—	420	277
Gain on acquisition	1,214	—	1,214	—
<b>TOTAL NONINTEREST INCOME</b>	<b>2,046</b>	<b>914</b>	<b>5,388</b>	<b>2,890</b>
Noninterest expense				
Compensation and benefits	3,125	2,651	8,784	8,222
Occupancy and equipment	867	686	2,273	2,068
Federal deposit insurance premiums	188	146	430	447
Merger-related costs	2	—	617	—
Professional fees	311	349	829	874
Marketing and advertising	132	76	303	267
Foreclosed real estate expense	114	78	573	705
Core deposit intangible	25	—	25	—
Other operating	2,018	480	3,110	1,588
<b>TOTAL NONINTEREST EXPENSE</b>	<b>6,782</b>	<b>4,466</b>	<b>16,944</b>	<b>14,171</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>2,149</b>	<b>1,952</b>	<b>6,174</b>	<b>5,066</b>
Income tax expense	183	479	1,185	1,189
<b>NET INCOME</b>	<b>\$1,966</b>	<b>\$1,473</b>	<b>\$4,989</b>	<b>\$3,877</b>
Earnings per share—basic	\$0.64	\$0.54	\$1.75	\$1.42

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Earnings per share—diluted	\$0.64	\$0.54	\$1.75	\$1.42
Dividends paid per share	\$0.10	\$0.05	\$0.20	\$0.15
Weighted average shares outstanding:				
Basic	3,052	2,729	2,846	2,724
Diluted	3,055	2,732	2,847	2,727

The accompanying notes are an integral part of these statements



Table of Contents

TF FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Net income	\$1,966	\$1,473	\$4,989	\$3,877
Other comprehensive (loss) income:				
Investment securities available for sale:				
Unrealized holding (losses) gains	(242 )	544	(4,360 )	870
Tax effect	82	(185 )	1,482	(296 )
Net of tax amount	(160 )	359	(2,878 )	574
Pension plan benefit adjustment:				
Related to actuarial losses and prior service cost	66	71	198	214
Tax effect	(22 )	(24 )	(67 )	(73 )
Net of tax amount	44	47	131	141
Total other comprehensive (loss) income	(116 )	406	(2,747 )	715
Comprehensive income	\$1,850	\$1,879	\$2,242	\$4,592

The accompanying notes are an integral part of these statements

Table of Contents

## TF FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	For the nine months ended September 30, 2013                  2012 (in thousands)	
<b>OPERATING ACTIVITIES</b>		
Net income	\$4,989	\$3,877
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and impairment adjustment of mortgage loan servicing rights	(34 )	304
Premiums and discounts on investment securities, net	222	181
Premiums and discounts on mortgage-backed securities, net	323	229
Amortization of premiums on certificates of deposit	98	—
Deferred loan origination costs, net	142	132
Provision for loan losses	839	1,750
Amortization of core deposit intangible	25	—
Depreciation of premises and equipment	506	573
Increase in value of bank owned life insurance	(416 )	(456 )
Income from life insurance death benefit	(934 )	—
Stock-based compensation	588	366
Proceeds from sale of loans originated for sale	28,813	39,656
Origination of loans held for sale	(28,468 )	(39,512 )
Gain on acquisition	(1,214 )	—
Loss on foreclosed real estate	448	425
Gain on :		
Sale of loans	(635 )	(920 )
Disposition of premises and equipment	(420 )	(277 )
Decrease in:		
Accrued interest receivable	167	5
Other assets	1,642	644
(Decrease) increase in:		
Accrued interest payable	(94 )	(432 )
Other liabilities	424	944
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>7,011</b>	<b>7,489</b>
<b>INVESTING ACTIVITIES</b>		
Loan originations	(86,727 )	(110,383 )
Loan principal payments	91,605	65,723
Proceeds from sale of foreclosed real estate	1,641	6,736
Proceeds from disposition of premises and equipment	417	356
Proceeds from maturities of investment securities available for sale	5,545	5,300
Proceeds from bank owned life insurance	2,183	—
Principal repayments on mortgage-backed securities held to maturity	505	506

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Principal repayments on mortgage-backed securities available for sale	14,975	20,489
Purchase of investment securities available for sale	(13,088 )	(4,260 )
Purchase of mortgage-backed securities available for sale	(1,867 )	(13,520 )
Purchase of premises and equipment	(899 )	(387 )
Redemption of FHLB stock	2,395	1,408
Acquisition, net of cash acquired	(3,173 )	—
<b>NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES</b>	<b>13,512</b>	<b>(28,032 )</b>

Table of Contents

## TF FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	For the nine months ended September 30,	
	2013	2012
	(in thousands)	
<b>FINANCING ACTIVITIES</b>		
Net decrease in deposits	(6,339 )	(18,015 )
Net increase in short-term FHLB borrowings	—	14,304
Proceeds of long-term FHLB borrowings	—	32,197
Repayment of long-term FHLB borrowings	(12,717 )	(18,253 )
Net decrease in advances from borrowers for taxes and insurance	(965 )	(505 )
Purchase of treasury stock	(274 )	—
Exercise of stock options	216	7
Tax benefit (expense) arising from exercise of stock options	2	(1 )
Common stock dividends paid	(579 )	(407 )
<b>NET CASH (USED) PROVIDED BY FINANCING ACTIVITIES</b>	<b>(20,656 )</b>	<b>9,327</b>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(133 )</b>	<b>(11,216 )</b>
Cash and cash equivalents at beginning of period	31,137	14,928
Cash and cash equivalents at end of period	\$31,004	\$3,712
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for:		
Interest on deposits and borrowings	\$3,121	\$4,321
Income taxes	\$875	\$375
Noncash transactions:		
Capitalization of mortgage servicing rights	\$305	\$404
Transfers from loans to foreclosed real estate	\$557	\$2,925
<b>Acquisition of Roebing Financial Corp, Inc.</b>		
Noncash assets acquired:		
Investment securities		
Available for sale	\$37,260	
Held to maturity	79	
Loans	102,026	
FHLB stock	389	
Accrued interest receivable	376	
Premises and equipment, net	2,154	
Core deposit intangible	553	
Bank owned life insurance	175	
Other assets	1,685	
	144,697	
Liabilities assumed:		
Deposits	127,750	
Advances from the FHLB	3,051	

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Advances from borrowers for taxes and insurance	429
Other liabilities	1,408
	132,638
Net noncash assets acquired	12,059
Cash acquired	\$4,081

The accompanying notes are an integral part of these statements

Table of Contents

TF FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — PRINCIPLES OF CONSOLIDATION

The consolidated financial statements as of September 30, 2013 (unaudited) and December 31, 2012 and for the three and nine-month periods ended September 30, 2013 and 2012 (unaudited) include the accounts of TF Financial Corporation (the “Company”) and its wholly owned subsidiaries: 3rd Fed Bank (the “Bank”) and Penns Trail Development Corporation. The accompanying consolidated balance sheet at December 31, 2012, has been derived from the audited consolidated balance sheet but does not include all of the information and notes required by accounting principles generally accepted in the United States of America (“US GAAP”) for complete financial statements. The Company’s business is conducted principally through the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

NOTE 2 — BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements were prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all of the disclosures or footnotes required by US GAAP. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the consolidated financial statements have been included. The results of operations for the period ended September 30, 2013 are not necessarily indicative of the results which may be expected for the entire fiscal year or any other period. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

NOTE 3 — RECENT ACCOUNTING PRONOUNCEMENTS

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The amendments in this update require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under US GAAP to be reclassified in its entirety to net income. For other amounts that are not required under US GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under US GAAP that provide additional detail about those amounts. For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. The Company has provided the necessary disclosures in Note 6 – Accumulated Other Comprehensive (Loss) Income.

In February 2013, FASB issued ASU 2013-04, Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. The objective of the amendments in this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing guidance in US GAAP. Examples of obligations within the scope of this update include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. US GAAP does not include specific guidance on accounting for such obligations with joint and several liability, which has resulted in diversity in practice. Some entities record the entire amount under the joint and several liability arrangement on the basis of the concept of a liability and the guidance that must be met to extinguish a liability. Other entities record less than the total amount of the obligation, such as an amount allocated, an amount corresponding to the proceeds received, or the portion of the amount the entity agreed to pay

among its co-obligors, on the basis of the guidance for contingent liabilities. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. This ASU is not expected to have a significant impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-10, Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. The amendments in this update permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. This ASU is not expected to have a significant impact on the Company's financial statements.

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the

Table of Contents

reporting date. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

NOTE 4 — ACQUISITION OF ROEBLING FINANCIAL CORP, INC.

On July 2, 2013, the Company closed on a merger transaction pursuant to which the Company acquired Roebling Financial Corp, Inc. ("Roebling"), the parent company of Roebling Bank, in a stock and cash transaction.

Under the terms of the merger agreement, the Company acquired all of the outstanding shares of Roebling for a total purchase price of approximately \$14.9 million. As a result of the acquisition, the Company issued 306,873 common shares, or 20.31% of the total shares outstanding as of September 30, 2013, to former shareholders of Roebling. As a result of the merger, Roebling was merged with and into the Company, and Roebling Bank was merged with and into 3rd Fed Bank.



Table of Contents

The following table summarizes the purchase of Roebling as of July 2, 2013:

	At July 2, 2013 (in thousands, except per share data)
<b>Purchase Price Consideration in Common Stock</b>	
Roebling common shares settled for stock	843,058
Exchange Ratio	0.364
TF Financial Corporation shares issued	306,873
Value assigned to TF Financial Corporation common share	\$25.00
Purchase price assigned to Roebling common shares exchanged for TF Financial	\$7,672
<b>Purchase Price Consideration - Cash for Common Stock</b>	
Roebling shares exchanged for cash	843,478
Purchase price paid to each Roebling common share exchanged for cash	\$8.60
Purchase price assigned to Roebling common shares exchanged for cash	7,254
<b>Total Purchase Price</b>	<b>14,926</b>
<b>Net Assets Acquired:</b>	
Roebling shareholders' equity	\$16,461
<b>Adjustments to reflect assets acquired at fair value:</b>	
Investments	2
Loans	
Interest rate	932
General credit	(1,069 )
Specific credit - non-amortizing	(325 )
Specific credit - amortizing	(198 )
Eliminate allowance for loan losses	1,214
Core deposit intangible	553
Owned premises	(976 )
Leased premises contracts	33
Deferred tax assets	(276 )
Other assets	280
<b>Adjustments to reflect liabilities acquired at fair value:</b>	
Time deposits	(440 )
FHLB advances	(51 )
	16,140
<b>Purchase gain resulting from acquisition</b>	<b>\$1,214</b>

Table of Contents

The following condensed statement reflects the values assigned to Roebbling's net assets as of the acquisition date:

At July 2, 2013  
(in thousands)

Total purchase price		\$14,926
Net assets acquired:		
Cash	\$4,081	
Investment securities	37,339	
Loans	102,026	
Premises and equipment, net	2,154	
Core deposit intangible	553	
Other assets	2,625	
Time deposits	(49,061 )	
Deposits other than time deposits	(78,689 )	
Other liabilities	(4,888 )	
		16,140
Purchase gain on acquisition		\$1,214

The acquired assets and assumed liabilities were measured at preliminary estimated fair values. Management made certain estimates and exercised judgment in accounting for the acquisition. The following is a description of the methods used to determine fair value of significant assets and liabilities at the acquisition date:

Cash and cash equivalents — The Company acquired \$4.1 million in cash and cash equivalents, which management deemed to reflect fair value based on the short term nature of the asset.

Investment Securities — The Company acquired \$37.3 million in U.S. Government and federal agency and mortgage-backed securities that were recorded at fair value. Please refer to Note 9 - Fair Value Measurements and Fair Value of Financial Instruments for a discussion of methodologies used to determine fair value.

Loans — The Company acquired \$102.0 million in loans with and without evidence of credit quality deterioration. The loans consisted of residential mortgage loans, consumer loans which include second mortgage loans and home equity secured lines of credit, commercial real estate loans and other commercial loans.

Table of Contents

At the acquisition date, the Company recorded \$101.2 million of loans without evidence of credit quality deterioration and \$797,000 of loans acquired with evidence of credit quality deterioration. The following table reflects the composition of the loans acquired as well as the fair value adjustments made:

	At July 2, 2013		Total (in thousands)
	Loans acquired with no credit quality deterioration	Loans acquired loans with credit quality deterioration	
Residential			
Residential mortgages	\$54,965	\$ 21	\$54,986
Commercial			
Real estate-commercial	13,262	—	13,262
Real estate-residential	5,143	356	5,499
Real estate-multi-family	1,595	331	1,926
Commercial and industrial loans	308	—	308
Consumer			
Home equity and second mortgage	25,847	89	25,936
Other consumer	109	—	109
Total	\$101,229	\$ 797	\$102,026

The Company estimated the general credit risk fair value adjustment based on guidance from ASC 820-10, Fair Value Measurements which defines fair value as the price which would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is no active observable market for sale information on community bank loans and thus Level 3 fair value procedures were utilized, primarily the use of present value techniques incorporating assumptions which market participants would use in estimating fair values. In lieu of reliable market information, the Company used its own assumptions in an effort to determine a reasonable estimate of fair value. Loans acquired without credit quality deterioration were evaluated using a two-part general credit fair value analysis for all loan groups: 1) expected lifetime credit migration losses and 2) estimated fair value adjustment for qualitative factors. An adjustment of \$932,000 was made to reflect a general credit risk fair value. Additionally, the Company recorded an increase of \$1.1 million to reflect the fair value of loans based on current interest rates on loans similar to those acquired.

A specific credit fair value adjustment was made as prescribed by ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. Accordingly, the Company reviewed the Roebing loan portfolio on a loan by loan basis to determine whether loans met the definition of credit impaired as set forth in ASC 310-30. Specifically: 1) Had there been credit deterioration from the loan's inception until the acquisition date and 2) Is it probable that not all of the contractual cash flows will be collected on the loan. Based on this analysis, loans with a principal balance of \$1.3 million were identified as being within the scope of ASC 310-30. The Company estimated the cash flows on each loan whether from expected monthly payments or from the liquidation of the underlying collateral on collateral dependent loans. The contractual cash flows in excess of the aggregate expected cash flows resulted in a credit-related non-accretable yield in the amount of \$325,000. Additionally, the aggregate expected cash flows less the acquisition date fair value resulted in an accretable yield amount of \$198,000.

The following table contains the fair value adjustments on loans acquired without significant credit deterioration:

Fair value of loans acquired not accounted for under ASC 310-30	At July 2, 2013 (in thousands)
Contractual amount of acquired loans at acquisition	\$ 101,365
Contractual cash flows not expected to be collected (general credit valuation)	(1,068 )
Expected cash flows at acquisition	100,297
Interest rate fair value adjustment	932
Total	\$ 101,229

12

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Table of Contents

The following table contains the adjustments on loans acquired with credit deterioration:

	At July 2, 2013 (in thousands)
Fair value of loans acquired accounted for under ASC 310-30	
Contractual amount of acquired loans at acquisition	\$ 1,320
Contractual cash flows not expected to be collected (non-accretable yield)	(325 )
Expected cash flows at acquisition	995
Interest component of expected cash flows (accretable yield)	(198 )
Total	\$797

Premises and equipment, net — The Company acquired \$2.2 million in land and buildings because of the Roebing merger, which reflects fair value. The fair value as of the acquisition date was determined by an appraisal conducted by an independent qualified appraiser.

Core deposit intangible — The Company recorded a core deposit intangible of \$553,000. A core deposit intangible arises from a financial institution having a deposit base comprised of stable customer relationships. These deposits are generally at interest rates or on terms that are favorable to the financial institution. Fair value of the core deposit intangible was estimated based on guidance from ASC 820-10. There is no active observable market for sale information on community bank core deposits and thus Level 3 fair value procedures were utilized, primarily the use of the income approach which is based on an analysis of the expected after tax cash flow benefits of the acquired core deposits versus the cost of utilizing an alternative source (brokered deposits) for its funding. Core deposits exclude certificates of deposit and other accounts, which the Company judged to be non-core deposits. The cost of core deposits incorporated estimates of the costs of maintaining and supporting the deposits such as interest, branch expenses, personnel, and data processing. This cost was compared to the alternative funding source and the resulting economic benefit was discounted over the expected life of the acquired core deposits using a long-term market-based after tax rate of return.

Core deposit intangible is amortized over the expected useful life. The life is periodically reassessed to determine if any amortization period adjustments are required. During the three and nine months ended September 30, 2013, no such adjustments were recorded. The gross carrying amount of the core deposit intangible at September 30, 2013 was \$528,000 with \$25,000 accumulated amortization as of that date.

As of September 30, 2013, the current year and estimated future amortization expense for the core deposit intangible was as follows:

	At September 30, 2013 (in thousands)
2013	\$ 76
2014	91
2015	80
2016	70
2017	60
2018	50
2019	40
2020	30
2021	21

2022	10
	\$ 528

Deposits — The Company assumed \$127.8 million in deposits which included \$49.1 million of interest-bearing time deposits ("CDs"). An increase of \$440,000 was made to reflect the fair value of the CDs. This fair value adjustment is based on guidance derived from ASC 820-10 and is based on current market interest rates on CDs of the same remaining maturity as Roebbling's CDs. Market rates were obtained from independent third party sources for CDs offered in New Jersey on or about the acquisition date.

Table of Contents

Results of operations for Roebling prior to the acquisition date are not included in the Consolidated Statement of Income for the three and nine-month periods ended September 30, 2013. The following table presents financial information regarding the former Roebling operations included in the Consolidated Statement of Income from the date of acquisition through September 30, 2013 under the column “Actual from acquisition date through September 30, 2013”. In addition, the following table presents unaudited pro forma information as if the acquisition of Roebling had occurred on January 1, 2012 under the “Pro Forma” columns. The table below has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the acquisition occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma information does not reflect management’s estimate of any revenue-enhancing opportunities nor anticipated cost savings as a result of the integration and consolidation of the acquisition. Merger and acquisition integration costs and amortization of fair value adjustments net of the related income tax effects are included in the amounts below, but any purchase gain has been excluded.

	Actual from Acquisition Date Through September 30, 2013 (in thousands)			
Net interest income	\$ 1,119			
Noninterest income	123			
Net loss	(840 )			

  

	Pro Formas			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands, except per share data)			
Net interest income	\$7,759	\$8,698	\$23,917	\$22,130
Noninterest income	832	1,060	4,432	3,289
Net income	661	1,410	3,835	4,045
Pro forma earnings per share:				
Basic	\$0.22	\$0.46	\$1.26	\$1.33
Diluted	\$0.22	\$0.46	\$1.26	\$1.33

Table of Contents

## NOTE 5 — EARNINGS PER SHARE

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

	For the three months ended September 30, 2013		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount
Basic earnings per share			
Income available to common stockholders	\$1,966	3,051,581	\$0.64
Effect of dilutive securities			
Stock options and grants	—	3,903	—
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$1,966	3,055,484	\$0.64
	For the nine months ended September 30, 2013		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount
Basic earnings per share			
Income available to common stockholders	\$4,989	2,845,608	\$1.75
Effect of dilutive securities			
Stock options and grants	—	1,316	—
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$4,989	2,846,924	\$1.75

There were 31,963 options to purchase shares of common stock with exercise prices ranging from \$25.71 to \$32.51 per share which were outstanding during the three and nine months ended September 30, 2013 that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common stock.



Table of Contents

	For the three months ended September 30, 2012		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount
Basic earnings per share			
Income available to common stockholders	\$1,473	2,728,534	\$0.54
Effect of dilutive securities			
Stock options and grants	—	3,119	—
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$1,473	2,731,653	\$0.54
	For the nine months ended September 30, 2012		
	Income (numerator)	Weighted average shares (denominator)	Per share Amount
Basic earnings per share			
Income available to common stockholders	\$3,877	2,723,703	\$1.42
Effect of dilutive securities			
Stock options and grants	—	3,668	—
Diluted earnings per share			
Income available to common stockholders plus effect of dilutive securities	\$3,877	2,727,371	\$1.42

There were 65,337 options to purchase shares of common stock with exercise prices ranging from \$23.53 to \$32.51 per share which were outstanding during the three and nine months ended September 30, 2012 that were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common stock.

Table of Contents

## NOTE 6 — ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

The activity in accumulated other comprehensive (loss) income for the three months ended September 30, 2013 and 2012 is as follows:

	Accumulated Other Comprehensive (Loss) Income (1), (2)		
	Unrealized gains (losses) on securities available for sale	Defined benefit pension plan (in thousands)	Total
Balance at June 30, 2013	\$ 1,087	\$ (2,748 )	\$ (1,661 )
Other comprehensive loss before reclassifications	(160 )	—	(160 )
Amounts reclassified from accumulated other comprehensive income (loss)	—	44	44
Period change	(160 )	44	(116 )
Balance at September 30, 2013	\$ 927	\$ (2,704 )	\$ (1,777 )
Balance at June 30, 2012	\$ 3,864	\$ (2,809 )	\$ 1,055
Other comprehensive income before reclassifications	359	—	359
Amounts reclassified from accumulated other comprehensive income (loss)	—	47	47
Period change	359	47	406
Balance at September 30, 2012	\$ 4,223	\$ (2,762 )	\$ 1,461

(1) All amounts are net of tax. Related income tax expense or benefit is calculated using a Federal income tax rate of 34%.

(2) Amounts in parentheses indicate debits.

	Amount reclassified from accumulated other comprehensive income (loss) For the three months ended September 30, (2)		Affected line item in the consolidated statements of income
	2013	2012	
	(in thousands)		
Defined benefit pension plan (1)			
Amortization of net actuarial loss	\$ 66	\$ 71	Compensation and benefits
Related income tax expense	(22 )	(24 )	Income tax expense
Net effect on accumulated other comprehensive income for the period	\$ 44	\$ 47	Net income

(1) Included in the computation of net periodic pension cost. See Note 11 – Employee Benefit Plans for additional detail.

(2) Amounts in parentheses indicate debits.



Table of Contents

The activity in accumulated other comprehensive (loss) income for the nine months ended September 30, 2013 and 2012 is as follows:

	Accumulated Other Comprehensive (Loss) Income (1), (2)		
	Unrealized gains (losses) on securities available for sale	Defined benefit pension plan (in thousands)	Total
Balance at December 31, 2012	\$ 3,805	\$ (2,835 )	\$ 970
Other comprehensive loss before reclassifications	(2,878 )	—	(2,878 )
Amounts reclassified from accumulated other comprehensive income	—	131	131
Period change	(2,878 )	131	(2,747 )
Balance at September 30, 2013	\$ 927	\$ (2,704 )	\$ (1,777 )
Balance at December 31, 2011	\$ 3,649	\$ (2,903 )	\$ 746
Other comprehensive income before reclassifications	574	—	574
Amounts reclassified from accumulated other comprehensive income	—	141	141
Period change	574	141	715
Balance at September 30, 2012	\$ 4,223	\$ (2,762 )	\$ 1,461

(1) All amounts are net of tax. Related income tax expense or benefit is calculated using a Federal income tax rate of 34%.

(2) Amounts in parentheses indicate debits.

	Amount reclassified from accumulated other comprehensive income (loss) For the nine months ended September 30, (2)		Affected line item in the consolidated statements of income
	2013	2012	
	(in thousands)		
Defined benefit pension plan (1)			
Amortization of net actuarial loss	\$ 198	\$ 214	Compensation and benefits
Related income tax expense	(67 )	(73 )	Income tax expense
Net effect on accumulated other comprehensive income for the period	\$ 131	\$ 141	Net income

(1) Included in the computation of net periodic pension cost. See Note 11 – Employee Benefit Plans for additional detail.

(2) Amounts in parentheses indicate debits.

Table of Contents

## NOTE 7 — INVESTMENT SECURITIES

The amortized cost, gross unrealized gains and losses, and fair value of the Company's investment securities are summarized as follows:

		At September 30, 2013		
	Amortized	Gross	Gross	Fair
	cost	unrealized	unrealized	value
		gains	losses	
		(in thousands)		
Available for sale				
U.S. Government and federal agencies	\$22,576	\$34	\$(311)	\$22,299
State and political subdivisions	58,571	1,721	(687)	59,605
Residential mortgage-backed securities issued by quasi-governmental agencies	46,522	749	(101)	47,170
Total investment securities available for sale	127,669	2,504	(1,099)	129,074
Held to maturity				
Residential mortgage-backed securities issued by quasi-governmental agencies	1,540	179	—	1,719
Total investment securities	\$129,209	\$2,683	\$(1,099)	\$130,793
		At December 31, 2012		
	Amortized	Gross	Gross	Fair
	cost	unrealized	unrealized	value
		gains	losses	
		(in thousands)		
Available for sale				
State and political subdivisions	\$55,254	\$4,360	\$(4)	\$59,610
Residential mortgage-backed securities issued by quasi-governmental agencies	41,265	1,409	—	42,674
Total investment securities available for sale	96,519	5,769	(4)	102,284
Held to maturity				
Residential mortgage-backed securities issued by quasi-governmental agencies	1,965	306	—	2,271
Total investment securities	\$98,484	\$6,075	\$(4)	\$104,555

There were no sales of investment securities during the three and nine months ended September 30, 2013 or 2012.

Table of Contents

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

	At September 30, 2013			
	Available for sale Amortized cost	Fair value	Held to maturity Amortized cost	Fair value
	(in thousands)			
Investment securities				
Due in one year or less	\$1,649	\$1,681	\$—	\$—
Due after one year through five years	19,218	19,564	—	—
Due after five years through ten years	39,321	39,373	—	—
Due after ten years	20,959	21,286	—	—
	81,147	81,904	—	—
Mortgage-backed securities	46,522	47,170	1,540	1,719
Total investment and mortgage-backed securities	\$127,669	\$129,074	\$1,540	\$1,719

The table below indicates the length of time individual securities have been in a continuous unrealized loss position at September 30, 2013:

Description of Securities	Number of Securities	Less than 12 months		12 months or longer		Total	
		Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
(dollars in thousands)							
U.S. Government and federal agencies	10	\$ 14,325	\$ (311 )	\$ —	\$ —	\$ 14,325	\$ (311 )
State and political subdivisions	17	15,751	(687 )	—	—	15,751	(687 )
Residential mortgage-backed securities							
issued by quasi-governmental agencies	37	16,100	(101 )	—	—	16,100	(101 )
Total temporarily impaired securities	64	\$ 46,176	\$ (1,099 )	\$ —	\$ —	\$ 46,176	\$ (1,099 )

The table below indicates the length of time individual securities have been in a continuous unrealized loss position at December 31, 2012:

Description of Securities	Number of Securities	Less than 12 months		12 months or longer		Total	
		Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
(dollars in thousands)							
State and political subdivisions	1	\$ 617	\$ (4 )	\$ —	\$ —	\$ 617	\$ (4 )
Total temporarily impaired securities	1	\$ 617	\$ (4 )	\$ —	\$ —	\$ 617	\$ (4 )

On a quarterly basis, temporarily impaired securities are evaluated to determine whether such impairment is an other-than-temporary impairment (“OTTI”). The Company has performed this evaluation and has determined that the

unrealized losses at September 30, 2013 and December 31, 2012, respectively, are not considered other-than-temporary but are the result of changes in interest rates, and are therefore reflected in other comprehensive (loss) income.

Table of Contents

## NOTE 8 — LOANS RECEIVABLE

Loans receivable are summarized as follows:

	September 30, 2013	At	December 31, 2012
	(in thousands)		
Held for investment:			
Residential			
Residential mortgages	\$ 379,358		\$ 323,665
Commercial			
Real estate-commercial	122,635		104,766
Real estate-residential	25,852		21,570
Real estate-multi-family	18,625		19,118
Construction loans	9,351		16,288
Commercial and industrial loans	5,885		4,646
Total commercial loans	182,348		166,388
Consumer			
Home equity and second mortgage	64,377		40,143
Other consumer	1,813		1,835
Total consumer loans	66,190		41,978
Total loans	627,896		532,031
Net deferred loan origination costs, and unamortized premiums and discounts	1,125		1,611
Less allowance for loan losses	(6,691 )		(6,922 )
Total loans receivable	\$ 622,330		\$ 526,720
Held for sale:			
Residential			
Residential mortgages	\$ 691		\$ 706



Table of Contents

The following tables present by credit quality indicators the composition of the commercial loan portfolio:

	At September 30, 2013				
	Pass	Special mention	Substandard	Doubtful	Total
	(in thousands)				
Real estate-commercial	\$ 106,412	\$ 7,194	\$ 9,029	\$ —	\$ 122,635
Real estate-residential	22,828	490	2,534	—	25,852
Real estate-multi-family	14,957	—	3,668	—	18,625
Construction loans	6,174	—	3,177	—	9,351
Commercial and industrial loans	5,853	32	—	—	5,885
Total	\$ 156,224	\$ 7,716	\$ 18,408	\$ —	\$ 182,348

	At December 31, 2012				
	Pass	Special mention	Substandard	Doubtful	Total
	(in thousands)				
Real estate-commercial	\$ 91,446	\$ 4,192	\$ 9,128	\$ —	\$ 104,766
Real estate-residential	19,244	1,018	1,308	—	21,570
Real estate-multi-family	15,751	—	3,367	—	19,118
Construction loans	7,397	4,097	4,794	—	16,288
Commercial and industrial loans	4,565	81	—	—	4,646
Total	\$ 138,403	\$ 9,388	\$ 18,597	\$ —	\$ 166,388

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

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

**Special mention:** A loan that has potential weaknesses that deserves management's close attention. Although the loan is currently protected, if left uncorrected, potential weaknesses may result in the deterioration of the loan's repayment prospects or in the borrower's future credit position. Potential weaknesses include: weakening financial condition; an unrealistic repayment program; inadequate sources of funds; lack of adequate collateral; credit information; or documentation. There is currently the capacity to meet interest and principal payments, but further adverse business, financial, or economic conditions may impair the borrower's capacity or willingness to pay interest and repay principal.

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

meet timely payment of interest and repayment of principal.

Doubtful: A loan which has all the weaknesses inherent in a substandard asset with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable

Table of Contents

and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors which may work to strengthen the asset, classification as an estimated loss is deferred until a more exact status is determined. Pending factors include: proposed merger, acquisition, liquidation, capital injection, perfecting liens on additional collateral, and refinancing plans.

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

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

The following tables present by credit quality indicator the composition of the residential mortgage and consumer loan portfolios:

	At September 30, 2013		
	Performing	Nonperforming	Total
	(in thousands)		
Residential mortgages	\$377,257	\$ 2,101	\$379,358
Home equity and second mortgage	64,160	217	64,377
Other consumer	1,812	1	1,813
Total	\$443,229	\$ 2,319	\$445,548

  

	At December 31, 2012		
	Performing	Nonperforming	Total
	(in thousands)		
Residential mortgages	\$321,400	\$ 2,265	\$323,665
Home equity and second mortgage	40,000	143	40,143
Other consumer	1,827	8	1,835
Total	\$363,227	\$ 2,416	\$365,643

In order to assess and monitor the credit risk associated with residential mortgage loans and consumer loans which include second mortgage loans and home equity secured lines of credit, the Company relies upon the payment status of the loan. Residential mortgage and other consumer loans 90 days or more past due are placed on nonaccrual status, classified as nonperforming, and evaluated for impairment.

Table of Contents

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

	September 30, 2013	At December 31, 2012
	(in thousands)	
Residential		
Residential mortgages	\$ 2,101	\$ 2,265
Commercial		
Real estate-commercial	785	1,098
Real estate-residential	684	51
Real estate-multi-family	149	—
Construction loans	2,944	4,794
Consumer		
Home equity and second mortgage	217	143
Other consumer	1	8
Total nonperforming loans	\$ 6,881	\$ 8,359
Total loans past due 90 days as to interest or principal and accruing interest	\$ —	\$ —

Table of Contents

The following tables present by class loans individually evaluated for impairment:

	At September 30, 2013				
	Recorded investment	Unpaid principal balance	Related allowance (in thousands)	Average recorded investment	Interest income recognized
With an allowance recorded:					
Residential					
Residential mortgages	\$ 1,209	\$ 1,217	\$ 85	\$ 1,831	\$—
Commercial					
Real estate-commercial	—	—	—	137	—
Real estate-residential	342	342	47	86	—
Construction loans	2,944	3,142	2,000	3,832	—
	4,495	4,701	2,132	5,886	—
With no allowance recorded:					
Commercial					
Real estate-commercial	552	552	—	552	—
Real estate-residential	—	—	—	136	—
Loans acquired with deteriorated credit quality	813	1,320	—	271	—
	1,365	1,872	—	959	—
Total	\$ 5,860	\$ 6,573	\$ 2,132	\$ 6,845	\$—

	At December 31, 2012				
	Recorded investment	Unpaid principal balance	Related allowance (in thousands)	Average recorded investment	Interest income recognized
With an allowance recorded:					
Residential					
Residential mortgages	\$ 2,137	\$ 2,214	\$ 218	\$ 2,061	\$—
Commercial					
Real estate-commercial	546	1,497	296	697	—
Real estate-residential	51	51	4	298	—
Construction loans	4,737	5,137	1,029	3,604	—
Commercial and industrial loans	—	—	—	2	—
	7,471	8,899	1,547	6,662	—
With no allowance recorded:					
Residential					
Residential mortgages	—	—	—	698	—
Commercial					
Real estate-commercial	552	552	—	1,012	—
Real estate-residential	—	—	—	216	—
Construction loans	57	116	—	1,932	—
	609	668	—	3,858	—
Total	\$ 8,080	\$ 9,567	\$ 1,547	\$ 10,520	\$—

Table of Contents

The following tables present by class the contractual aging of delinquent loans:

At September 30, 2013

	Current	30-59 Days past due	60-89 Days past due	Loans past due 90 days or more (in thousands)	Total past due	Total loans	Recorded investment over 90 days and accruing interest
Residential							
Residential mortgages	\$ 375,676	\$ 1,637	\$ 10	\$ 2,035	\$ 3,682	\$ 379,358	\$ —
Commercial							
Real estate-commercial	121,850	—	—	785	785	122,635	—
Real estate-residential	24,798	—	370	684	1,054	25,852	—
Real estate-multi-family	18,289	187	—	149	336	18,625	—
Construction loans	6,174	—	233	2,944	3,177	9,351	—
Commercial and industrial loans	5,885	—	—	—	—	5,885	—
Consumer							
Home equity and second mortgage	64,048	60	52	217	329	64,377	—
Other consumer	1,808	4	—	1	5	1,813	—
Total	\$ 618,528	\$ 1,888	\$ 665	\$ 6,815	\$ 9,368	\$ 627,896	\$ —

At December 31, 2012

	Current	30-59 Days past due	60-89 Days past due	Loans past due 90 days or more (in thousands)	Total past due	Total loans	Recorded investment over 90 days and accruing interest
Residential							
Residential mortgages	\$ 319,982	\$ 1,161	\$ 329	\$ 2,193	\$ 3,683	\$ 323,665	\$ —
Commercial							
Real estate-commercial	102,868	800	—	1,098	1,898	104,766	—
	21,488	31	—	51	82	21,570	—

Real estate-residential							
Real estate-multi-family	19,118	—	—	—	—	19,118	—
Construction loans	11,494	—	—	4,794	4,794	16,288	—
Commercial and industrial loans	4,646	—	—	—	—	4,646	—
Consumer Home equity and second mortgage	39,842	34	124	143	301	40,143	—
Other consumer	1,824	—	3	8	11	1,835	—
Total	\$ 521,262	\$ 2,026	\$ 456	\$ 8,287	\$ 10,769	\$ 532,031	\$ —

Table of Contents

Activity in the allowance for loan losses for the three and nine months ended September 30, 2013 is summarized as follows:

	Balance July 1, 2013	Provision	Charge-offs (in thousands)	Recoveries	Balance September 30, 2013
Residential					
Residential mortgages	\$1,780	\$175	\$(184 )	\$—	\$1,771
Commercial					
Real estate-commercial	1,237	(104 )	—	—	1,133
Real estate-residential	360	53	(31 )	—	382
Real estate-multi-family	172	(35 )	—	—	137
Construction loans	2,342	(62 )	—	—	2,280
Commercial and industrial loans	71	5	(9 )	3	70
Consumer					
Home equity and second mortgage	210	5	—	—	215
Other consumer	24	3	(5 )	1	23
Unallocated	720	(40 )	—	—	680
Total	\$6,916	\$—	\$(229 )	\$4	\$6,691

	Balance January 1, 2013	Provision	Charge-offs (in thousands)	Recoveries	Balance September 30, 2013
Residential					
Residential mortgages	\$1,849	\$301	\$(391 )	\$12	\$1,771
Commercial					
Real estate-commercial	1,754	(186 )	(435 )	—	1,133
Real estate-residential	608	(136 )	(90 )	—	382
Real estate-multi-family	245	(108 )	—	—	137
Construction loans	1,697	719	(150 )	14	2,280
Commercial and industrial loans	119	(47 )	(9 )	7	70
Consumer					
Home equity and second mortgage	251	(29 )	(15 )	8	215
Other consumer	11	33	(24 )	3	23
Unallocated	388	292	—	—	680
Total	\$6,922	\$839	\$(1,114 )	\$44	\$6,691



Table of Contents

Activity in the allowance for loan losses for the three and nine months ended September 30, 2012 is summarized as follows:

	Balance July 1, 2012	Provision	Charge-offs (in thousands)	Recoveries	Balance September 30, 2012
<b>Residential</b>					
Residential mortgages	\$1,620	\$373	\$(126 )	\$46	\$1,913
<b>Commercial</b>					
Real estate-commercial	1,913	100	(18 )	—	1,995
Real estate-residential	699	(52 )	(1 )	—	646
Real estate-multi-family	284	(34 )	—	—	250
Construction loans	1,002	166	(31 )	—	1,137
Commercial and industrial loans	137	(41 )	—	9	105
<b>Consumer</b>					
Home equity and second mortgage	265	(25 )	(11 )	—	229
Other consumer	12	8	(9 )	—	11
Unallocated	231	255	—	—	486
<b>Total</b>	<b>\$6,163</b>	<b>\$750</b>	<b>\$(196 )</b>	<b>\$55</b>	<b>\$6,772</b>

	Balance January 1, 2012	Provision	Charge-offs (in thousands)	Recoveries	Balance September 30, 2012
<b>Residential</b>					
Residential mortgages	\$2,194	\$365	\$(702 )	\$56	\$1,913
<b>Commercial</b>					
Real estate-commercial	2,819	108	(932 )	—	1,995
Real estate-residential	464	600	(418 )	—	646
Real estate-multi-family	358	(108 )	—	—	250
Construction loans	1,260	768	(891 )	—	1,137
Commercial and industrial loans	138	106	(156 )	17	105
<b>Consumer</b>					
Home equity and second mortgage	448	(187 )	(32 )	—	229
Other consumer	22	9	(23 )	3	11
Unallocated	397	89	—	—	486
<b>Total</b>	<b>\$8,100</b>	<b>\$1,750</b>	<b>\$(3,154 )</b>	<b>\$76</b>	<b>\$6,772</b>

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

Loans receivable include certain loans that have been modified as Troubled Debt Restructurings (“TDRs”), where economic concessions have been granted to borrowers experiencing financial difficulties. The objective for granting the concessions is to maximize the recovery of the investment in the loan and may include reductions in the interest rate, payment extensions, forgiveness of interest or principal, forbearance or other actions. TDRs are classified as

nonperforming at the time of restructuring and typically

28

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Table of Contents

return to performing status after considering the borrower's positive repayment performance for a reasonable period of time, at least six months.

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

There were no loans classified as TDRs for the three and nine months ended September 30, 2013. The following tables present by class loans classified as TDRs for the three and nine months ended September 30, 2012:

	For the three months ended September 30, 2012			For the nine months ended September 30, 2012		
	Number of Contracts	Pre-Modification	Post Modification	Number of Contracts	Pre-Modification	Post Modification
Outstanding Recorded Investment (in thousands)		Outstanding Recorded Investment (in thousands)	Outstanding Recorded Investment (in thousands)		Outstanding Recorded Investment (in thousands)	
Residential						
Residential mortgage	—	\$—	\$—	1	\$852	\$ 852
Total	—	\$—	\$—	1	\$852	\$ 852

The following table presents loans classified as TDRs that subsequently defaulted:

	For the three months ended September 30, 2013		For the nine months ended September 30, 2013	
	Number of Contracts (in thousands)	Recorded Investment (in thousands)	Number of Contracts (in thousands)	Recorded Investment (in thousands)
Residential				
Residential mortgage	1	\$337	1	\$337
Total	1	\$337	1	\$337

During the first quarter of 2012, a TDR totaling \$167,000 which had been previously identified as in default of its modified terms was repaid and a \$40,000 loss was charged to the allowance for loan losses.

Acquired loans are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

The carrying value of the loans acquired and accounted for in accordance with ASC 310-30 was determined by projecting discounted contractual cash flows. The table below presents the components of the purchase accounting adjustments related to the purchased impaired loans acquired in the Roebling acquisition as of July 2, 2013:

At July 2,  
2013  
(in  
thousands)

Unpaid principal balance	\$	1,320
Interest		638
Contractual cash flows		1,958
Non-accretable discount		(963 )
Expected cash flows		995
Accretable discount		(198 )
Estimated fair value	\$	797

Table of Contents

Changes in the amortizable yield for purchased credit-impaired loans were as follows for the three months ended September 30, 2013:

	At September 30, 2013 (in thousands)	
Balance at beginning of period	\$	—
Acquisition of impaired loans		198
Accretion		(16)
Balance at end of period	\$	182

The following table presents additional information regarding loans acquired and accounted for in accordance with ASC 310-30:

	July 2, 2013 Acquired Loans with Specific Evidence of Deterioration in Credit Quality (ASC 310-30)		September 30, 2013 Acquired Loans with Specific Evidence of Deterioration in Credit Quality (ASC 310-30)	
	(in thousands)			
Outstanding balance	\$	1,958	\$	1,958
Carrying amount		797		813

There were no material increases or decreases in the expected cash flows of these loans between July 2, 2013 the acquisition date and September 30, 2013. There has been no allowance for loan losses recorded for acquired loans with or without specific evidence of deterioration in credit quality as of the acquisition date as well as those acquired without specific evidence of deterioration in credit quality as of September 30, 2013.

Table of Contents

The following tables present by class the ending balance of the allowance for loan losses and ending loan balance based on impairment method as of September 30, 2013:

Allowance	Evaluated for impairment			Total
	Loans acquired with credit deterioration	Individually	Collectively	
		(in thousands)		
Residential				
Residential mortgages	\$—	\$ 85	\$ 1,686	\$ 1,771
Commercial				
Real estate-commercial	—	—	1,133	1,133
Real estate-residential	—	47	335	382
Real estate-multi-family	—	—	137	137
Construction loans	—	2,000	280	2,280
Commercial and industrial loans	—	—	70	70
Consumer				
Home equity and second mortgage	—	—	215	215
Other consumer	—	—	23	23
Unallocated	—	—	680	680
Total	\$—	\$ 2,132	\$ 4,559	\$ 6,691

Loan balance	Evaluated for impairment			Total
	Loans acquired with credit deterioration	Individually	Collectively	
		(in thousands)		
Residential				
Residential mortgages	\$22	\$ 1,209	\$ 378,127	\$ 379,358
Commercial				
Real estate-commercial	—	552	122,083	122,635
Real estate-residential	363	342	25,147	25,852
Real estate-multi-family	338	—	18,287	18,625
Construction loans	—	2,944	6,407	9,351
Commercial and industrial loans	—	—	5,885	5,885
Consumer				
Home equity and second mortgage	90	—	64,287	64,377
Other consumer	—	—	1,813	1,813
Total	\$813	\$ 5,047	\$ 622,036	\$ 627,896

Table of Contents

The following tables present by class the ending balance of the allowance for loan losses and ending loan balance based on impairment method as of December 31, 2012:

Allowance	Evaluated for impairment		Total
	Individually	Collectively (in thousands)	
Residential			
Residential mortgages	\$218	\$1,631	\$1,849
Commercial			
Real estate-commercial	296	1,458	1,754
Real estate-residential	4	604	608
Real estate-multi-family	—	245	245
Construction loans	1,029	668	1,697
Commercial and industrial loans	—	119	119
Consumer			
Home equity and second mortgage	—	251	251
Other consumer	—	11	11
Unallocated	—	388	388
Total	\$1,547	\$5,375	\$6,922
Loan balance			
Residential			
Residential mortgages	\$2,137	\$321,528	\$323,665
Commercial			
Real estate-commercial	1,098	103,668	104,766
Real estate-residential	51	21,519	21,570
Real estate-multi-family	—	19,118	19,118
Construction loans	4,794	11,494	16,288
Commercial and industrial loans	—	4,646	4,646
Consumer			
Home equity and second mortgage	—	40,143	40,143
Other consumer	—	1,835	1,835
Total	\$8,080	\$523,951	\$532,031

Table of Contents

## NOTE 9 — FAIR VALUE MEASUREMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

The following tables present information about the Company's financial instruments measured at fair value as of September 30, 2013 and December 31, 2012. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement hierarchy has been established for inputs in valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Determination of the appropriate level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement for the instrument or security.

The fair value hierarchy levels are summarized below:

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

Assets measured at fair value on a recurring basis segregated by fair value hierarchy level are summarized below:

	Fair value hierarchy levels			Balance as of
	Level 1	Level 2	Level 3	September 30, 2013
	(in thousands)			
Assets				
Investment securities available for sale				
U.S. Government and federal agencies	\$—	\$22,299	\$—	\$22,299
State and political subdivisions	—	59,605	—	59,605
Residential mortgage-backed securities issued by quasi-governmental agencies	—	47,170	—	47,170
Total investment securities available for sale	\$—	\$129,074	\$—	\$129,074
Loans receivable, held for sale	\$—	\$691	\$—	\$691
	Fair value hierarchy levels			Balance as of
	Level 1	Level 2	Level 3	December 31, 2012
	(in thousands)			
Assets				
Investment securities available for sale				
State and political subdivisions	\$—	\$59,610	\$—	\$59,610
Residential mortgage-backed securities issued by quasi-governmental agencies	—	42,674	—	42,674



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Total investment securities available for sale	\$—	\$102,284	\$—	\$102,284
Loans receivable, held for sale	\$—	\$706	\$—	\$706

33

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Table of Contents

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

Values for loans held for sale utilize active pricing quotes which exist in the secondary market and are therefore deemed a Level 2 hierarchy.

Assets measured at fair value on a nonrecurring basis segregated by fair value hierarchy level at September 30, 2013 are summarized below:

	Fair value hierarchy levels			Balance as of September 30, 2013
	Level 1	Level 2	Level 3	
	(in thousands)			
Impaired loans	\$—	\$—	\$3,728	\$3,728
Real estate acquired through foreclosure	—	—	5,786	5,786
Mortgage servicing rights	—	1,471	—	1,471

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Bank has utilized Level 3 inputs to determine fair value at September 30, 2013:

Description	Fair value estimate (in thousands)	Valuation technique	Unobservable Input	Range of inputs
Impaired loans	\$3,728	Appraisal of collateral (1)	Discount rate to reflect current market conditions and ultimate recoverability	5%-15 %
Real estate acquired through foreclosure	5,786	Appraisal of collateral (1)	Discount rate to reflect current market conditions and liquidation expenses	5%-20 %

(1) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.

Table of Contents

The fair value of impaired loans and real estate acquired through foreclosure is generally determined through independent appraisals of the underlying collateral, which generally include level 3 inputs which are not identifiable. Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses are presented as a percent of the appraised value.

Assets measured at fair value on a nonrecurring basis segregated by fair value hierarchy level at December 31, 2012 are summarized below:

	Fair value hierarchy levels			Balance as of December 31, 2012
	Level 1	Level 2	Level 3	
	(in thousands)			
Impaired loans	\$—	\$—	\$6,533	\$6,533
Real estate acquired through foreclosure	—	—	7,282	7,282
Mortgage servicing rights	—	956	—	956

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Bank has utilized Level 3 inputs to determine fair value at December 31, 2012:

Description	Fair value estimate (in thousands)	Valuation technique	Unobservable Input	Range of inputs
Impaired loans	\$6,533	Appraisal of collateral (1)	Discount rate to reflect current market conditions and ultimate recoverability	5%-15 %
Real estate acquired through foreclosure	7,282	Appraisal of collateral (1)	Discount rate to reflect current market conditions and liquidation expenses	5%-20 %

(1) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.

The Company retains a qualified valuation service to calculate the amortized cost and to determine the fair value of the mortgage servicing rights. The valuation service utilizes discounted cash flow analyses adjusted for prepayment speeds, market discount rates and conditions existing in the secondary servicing market. Hence, the fair value of mortgage servicing rights is deemed a Level 2 hierarchy. The amortized cost basis of the Company's mortgage servicing rights was \$1.3 million and \$1.1 million at September 30, 2013 and December 31, 2012, respectively. The fair value of the mortgage servicing rights was \$1.5 million and \$956,000 at September 30, 2013 and December 31, 2012, respectively, and was included in other assets in the consolidated balance sheets.

In addition to financial instruments recorded at fair value in the Company's financial statements, disclosure of the estimated fair value of all of an entity's assets and liabilities considered to be financial instruments is also required. For the Bank, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments. However, many such instruments lack an available trading market as characterized by a willing buyer

and willing seller engaging in an exchange transaction. Also, it is the Company's general practice and intent to hold its financial instruments to maturity or available for sale and to not engage in trading or significant sales activities. For fair value disclosure purposes, the Company substantially utilized the established fair value measurement hierarchy.

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

Table of Contents

Fair values have been estimated using data which management considered the best available, as generally provided by estimation methodologies deemed suitable for the pertinent category of financial instrument. The recorded carrying amounts and fair values segregated by fair value hierarchy level at September 30, 2013 are summarized below:

	Carrying value	Fair value	Fair value hierarchy levels		
			Level 1	Level 2	Level 3
(in thousands)					
<b>Assets</b>					
Cash and cash equivalents	\$31,004	\$31,004	\$31,004	\$—	\$—
Investment securities	81,904	81,904	—	81,904	—
Mortgage-backed securities	48,710	48,889	—	48,889	—
Loans receivable, including loans held for sale	623,021	627,032	—	691	626,341
<b>Liabilities</b>					
Deposits with stated maturities	\$193,283	\$196,311	\$—	\$—	\$196,311
Deposits with no stated maturities	488,542	488,542	488,542	—	—
Borrowings with stated maturities	50,990	49,935	—	—	49,935

The recorded carrying amounts and fair values segregated by fair value hierarchy level at December 31, 2012 are summarized below:

	Carrying value	Fair value	Fair value hierarchy levels		
			Level 1	Level 2	Level 3
(in thousands)					
<b>Assets</b>					
Cash and cash equivalents	\$31,137	\$31,137	\$31,137	\$—	\$—
Investment securities	59,610	59,610	—	59,610	—
Mortgage-backed securities	44,639	44,945	—	44,945	—
Loans receivable, including loans held for sale	527,426	539,665	—	706	538,959
<b>Liabilities</b>					
Deposits with stated maturities	\$171,417	\$175,025	\$—	\$—	\$175,025
Deposits with no stated maturities	388,898	388,898	388,898	—	—
Borrowings with stated maturities	60,656	60,939	—	—	60,939

The fair value of cash and cash equivalents equals the carrying amount. The fair value of investment and mortgage-backed securities is described and presented under fair value measurement guidelines as discussed earlier.

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

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

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

approximate the recorded carrying amounts.

36

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Table of Contents

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

## NOTE 10 — STOCK-BASED COMPENSATION

The Company has stock benefit plans that allow the Company to grant options and restricted stock to employees and directors. The awards, which have a term of up to 10 years when issued, vest over a two to five year period. The exercise price of each award equals the market price of the Company's stock on the date of the grant. The fair value of each option grant during the first nine months of 2013 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

Weighted average assumptions			
Dividend yield		0.81	%
Expected volatility		16.82	%
Risk-free interest rate		0.65	%
Fair value of options granted during the period		\$ 3.12	
Expected lives in years		5	

There were no stock options granted during the three or nine months ended September 30, 2012.

At September 30, 2013, there was \$421,000 of total unrecognized compensation cost, net of estimated forfeitures, related to non-vested awards under the Company's stock option plan. That cost is expected to be recognized over a weighted average period of 9.6 months. Option activity under the Company's stock option plan as of September 30, 2013 was as follows:

	Number of shares	Weighted average exercise price per share	At September 30, 2013	
			Weighted average remaining contractual term (in years)	Aggregate intrinsic value (\$000)
Outstanding at January 1, 2013	89,279	\$24.08		
Options granted	205,000	24.28		
Options exercised	(8,547 )	25.24		
Options forfeited	(3,635 )	27.30		
Options expired	(14,279 )	24.26		
Outstanding at September 30, 2013	267,818	\$24.14	2.93	\$1,062
Options exercisable at September 30, 2013	56,115	\$24.25	1.58	\$265

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

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

At September 30,	
2013	2012

(in thousands)

Options Exercised

Aggregate intrinsic value of options exercised	\$ 5	\$ 6
Cash receipts from options exercised	216	7



Table of Contents

The Company issues stock of the Company as payment for director fees as permitted by the 2011 Director Stock Compensation Plan. The cost associated with these grants is included as a component of stock-based compensation. The following tables provide information regarding the Company's stock-based compensation expense:

	For the three months ended September 30, 2013          2012 (in thousands)	
Stock-based compensation expense		
Director fees	\$38	\$38
Stock option expense	86	6
Employee Stock Ownership Plan ("ESOP") expense	79	68
Total stock-based compensation expense	\$203	\$112

The Bank reports ESOP expense in an amount equal to the fair value of shares released from the ESOP to employees less dividends received on the allocated shares in the plan used for debt service. Dividends on allocated shares used to reduce ESOP expense totaled \$9,000 and \$8,000 for the three months ended September 30, 2013 and 2012, respectively.

Stock-based compensation expense related to stock options resulted in a tax benefit of \$31,000 and \$2,000 for the three months ended September 30, 2013 and 2012, respectively.

	For the nine months ended September 30, 2013          2012 (in thousands)	
Stock-based compensation expense		
Director fees	\$108	\$112
Stock option expense	229	20
Employee Stock Ownership Plan ("ESOP") expense	225	210
Total stock-based compensation expense	\$562	\$342

The Bank reports ESOP expense in an amount equal to the fair value of shares released from the ESOP to employees less dividends received on the allocated shares in the plan used for debt service. Dividends on allocated shares used to reduce ESOP expense totaled \$26,000 and \$24,000 for the nine months ended September 30, 2013 and 2012, respectively.

Stock-based compensation expense related to stock options resulted in a tax benefit of \$70,000 and \$7,000 for the nine months ended September 30, 2013 and 2012, respectively.

Table of Contents

## NOTE 11 — EMPLOYEE BENEFIT PLANS

Net periodic defined benefit pension cost included the following:

	For the three months ended September 30, 2013                  2012 (in thousands)	
Components of net periodic benefit cost		
Service cost	\$206	\$184
Interest cost	89	90
Expected return on plan assets	(182 )	(161 )
Recognized net actuarial loss	66	71
Net periodic benefit cost	\$179	\$184

	For the nine months ended September 30, 2013                  2012 (in thousands)	
Components of net periodic benefit cost		
Service cost	\$617	\$552
Interest cost	266	270
Expected return on plan assets	(546 )	(483 )
Amortization of prior service cost	2	2
Recognized net actuarial loss	196	212
Net periodic benefit cost	\$535	\$553

Employer contributions of \$653,000 were made during the nine months ended September 30, 2013. There were no employer contributions for the nine months ended September 30, 2012.

## NOTE 12 — CONTINGENCIES

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

Table of Contents

TF FINANCIAL CORPORATION AND SUBSIDIARIES

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

GENERAL

The Company may from time to time make written or oral "forward-looking statements", including statements contained in the Company's filings with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q and the exhibits hereto), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995.

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

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

Financial Condition

The Company's total assets at September 30, 2013 and December 31, 2012 were \$833.3 million and \$711.8 million, respectively, representing an increase of \$121.5 million during the nine-month period which was largely due to the acquisition of Roebing. Loans receivable, net increased by \$95.6 million during the first nine months of 2013. The acquisition of Roebing resulted in an increase in loans receivable of \$102.0 million in addition to originations of consumer and single-family residential mortgage loans totaling \$64.8 million and originations of commercial loans totaling \$21.9 million. Offsetting these increases were principal repayments totaling \$91.6 million on loans. The Company increased the allowance for loan losses by \$839,000 and transferred \$557,000 from loans to real estate acquired through foreclosure. Loans receivable held for sale was relatively unchanged as originations of loans for sale in the secondary market totaled \$28.5 million and proceeds from loan sales totaled \$28.8 million. Investment securities increased by \$26.4 million mainly the result of securities acquired from Roebing totaling \$37.3 million and purchases of \$15.0 million. Offsetting these increases were principal repayments and maturities totaling \$21.0 million,

a decrease in the fair value of available for sale securities of \$4.4 million and net premium amortization of \$545,000.

Total liabilities increased by \$111.6 million during the first nine months of 2013. Deposit balances increased \$121.5 million during the period. The branches acquired from the Roebing acquisition resulted in an addition of \$127.8 million of deposits. Checking, money market and savings accounts increased by \$21.0 million, and retail CDs decreased by \$26.8 million during the first nine months of 2013. Advances from the FHLB decreased by \$12.8 million, the result of scheduled amortization and maturities including repayment of \$3.1 million of advances acquired from Roebing.

Total consolidated stockholders' equity of the Company was \$92.8 million or 11.1% of total assets at September 30, 2013. During the first nine months of 2013, the Company issued 306,873 shares of its common stock in conjunction with the Roebing acquisition that increased stockholders equity by \$7.7 million. Additionally the Company issued 22,767 shares of its common stock associated with the ESOP, the 2011 Director Stock Compensation Plan and the exercise of stock options which combined with stock option expense resulted in an increase to stockholders equity of \$803,000. Stockholder's equity was also increased by net income for the nine-month period of \$5.0 million. Offsetting these increases were cash dividends paid of \$579,000 a decrease in accumulated other comprehensive income net of tax of \$2.7 million, and repurchases of 10,412 of common stock totaling \$274,000. At September 30, 2013, there were approximately 99,000 shares available for repurchase under the previously announced share repurchase plan.

Table of Contents

## Asset Quality

Nonperforming assets include real estate owned, which is carried at estimated fair value less costs to sell and nonperforming loans. Nonperforming loans include loan balances 90 days or more past due and impaired loans for which the accrual of interest has been discontinued. The following table sets forth information regarding the Company's nonperforming assets:

Nonperforming Assets	September	At		September		
	30, 2013	December 31, 2012		30, 2012		
	(Dollars in thousands)					
Loans receivable, net:						
Residential						
Residential mortgages	\$2,101	\$ 2,265		\$2,122		
Commercial						
Real estate-commercial	785	1,098		1,116		
Real estate-residential	684	51		839		
Real estate-multi-family	149	—		—		
Construction loans	2,944	4,794		6,119		
Consumer						
Home equity and second mortgage	217	143		204		
Other consumer	1	8		—		
Total nonperforming loans	6,881	8,359		10,400		
Real estate owned	5,786	7,282		7,619		
Total nonperforming assets	\$12,667	\$ 15,641		\$18,019		
Total loans 90 days or more past due as to interest or principal and accruing interest	\$—	\$ —		\$—		
Ratio of nonperforming loans to gross loans	1.07	%	1.56	%	1.92	%
Ratio of nonperforming loans to total assets	1.10	%	1.17	%	1.49	%
Ratio of total nonperforming assets to total assets	1.52	%	2.20	%	2.59	%

Nonperforming construction loans include a participation in a commercial construction project with a principal balance due of \$3.1 million. The Bank has recorded a partial charge-off of \$198,000 from the allowance for loan losses equal to the difference between the recorded investment and a recent appraisal. Additionally, \$2.0 million of the allowance for loan losses has been allocated to this loan for a potential shortfall related to the disposition of the loan.

Foreclosed property at September 30, 2013 consisted of eight parcels of real estate with a combined carrying value of \$5.9 million. During the first nine months of 2013, the Bank foreclosed on six mortgage loans secured by residential property valued at \$557,000 which resulted in a charge to the allowance of \$481,000. Also, the Bank sold two properties acquired through foreclosure with an aggregate book value of \$1.6 million. All foreclosed properties are listed or are in the process of being listed with real estate agents for sale in a timely manner. Foreclosed real estate is included in other assets in the Consolidated Balance Sheets.

## Allowance for Loan Losses

The Bank provides valuation allowances for estimated losses from uncollectible loans. The allowance is increased by provisions charged to expense and reduced by net charge-offs. On a quarterly basis, the Company prepares an

allowance for loan losses (ALLL) analysis. In the analysis, the loan portfolio is segmented into groups of homogeneous loans that share similar risk characteristics: commercial loans secured by nonresidential or non-owner occupied residential real estate, construction, commercial and industrial loans, single-family residential and consumer which is predominately real estate secured by junior liens and home equity lines of credit. Each segment is assigned reserve factors based on quantitative and qualitative measurements. In addition, the Bank reviews its internally classified loans, its loans classified for regulatory purposes, delinquent loans, and other relevant information in order to isolate loans for further scrutiny as potentially impaired loans.

Table of Contents

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

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

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

Loans deemed impaired are evaluated to determine the estimated fair value of the collateral, and a portion of the ALLL will be allocated to the deficiency. Troubled collateral-dependent real estate secured loans are valued using the appraised value of the collateral, and a portion of the ALLL will be allocated to these loans based on the difference between the loan amount and the appraised value. If such amounts are judged by management to be permanent, they will be charged-off. In addition, if foreclosure is probable, a portion of the ALLL will be allocated to the estimated additional costs to acquire and the estimated costs to sell. Upon completion of the foreclosure process, these amounts will be charged-off.

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

Table of Contents

## RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

Net Income. The Company recorded net income of \$2.0 million, or \$0.64 per diluted share, for the three months ended September 30, 2013 as compared to net income of \$1.5 million, or \$0.54 per diluted share, for the three months ended September 30, 2012.

## Average Balance Sheet

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

	Three Months Ended September 30,						Average yld/cost	
	Average balance	2013 Interest	Average yld/cost		Average balance	2012 Interest		
<b>ASSETS</b>								
Interest-earning assets:								
Loans receivable(1)	\$622,416	\$6,947	4.43	%	\$527,195	\$6,436	4.86	%
Mortgage-backed securities	50,737	322	2.52	%	55,820	453	3.23	%
Investment securities(2)	86,942	814	3.71	%	64,304	699	4.32	%
Other interest-earning assets(3)	35,294	5	0.06	%	393	—	*	—
Total interest-earning assets	795,389	8,088	4.03	%	647,712	7,588	4.66	%
Noninterest-earning assets	48,405				46,168			
Total assets	\$843,794				\$693,880			
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>								
Interest-bearing liabilities:								
Deposits	\$691,646	\$799	0.46	%	\$538,637	\$803	0.59	%
Borrowings from the FHLB	55,358	219	1.57	%	66,740	338	2.01	%
Total interest-bearing liabilities	747,004	1,018	0.54	%	605,377	1,141	0.75	%
Noninterest-bearing liabilities	5,529				7,179			
Total liabilities	752,533				612,556			
Stockholders' equity	91,261				81,324			
Total liabilities and stockholders' equity	\$843,794				\$693,880			
Net interest income-tax equivalent basis		7,070				6,447		
Interest rate spread(4)-tax equivalent basis			3.49	%			3.91	%
Net yield on interest-earning assets(5)-tax equivalent basis			3.53	%			3.96	%
Ratio of average interest-earning assets to average interest-bearing liabilities			106.48	%			106.99	%
Less: tax-equivalent interest adjustments		(185)				(193)		
Net interest income		\$6,885				\$6,254		



Interest rate spread(4)	3.40	%	3.79	%
Net yield on interest-earning assets(5)	3.43	%	3.84	%

- (1) Nonperforming loans have been included in the appropriate average loan balance category, but interest on nonperforming loans has not been included for purposes of determining interest income.
- (2) Tax equivalent adjustments to interest on investment securities were \$185,000 and \$193,000 for the quarters ended September 30, 2013 and 2012, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.
- (3) Includes interest-bearing deposits in other banks.
- (4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.  
Net yield on interest-earning assets represents net interest income as a percentage of average
- (5) interest-earning assets.
- \* Is less than \$500 for period indicated.

Table of Contents

## Rate/Volume Analysis

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

	For the three months ended September 30, 2013 vs 2012		
	Volume	Rate	Net
Interest income:			
Loans receivable, net	\$3,379	\$(2,868)	\$511
Mortgage-backed securities	(38)	(93)	(131)
Investment securities (1)	642	(527)	115
Other interest-earning assets	1	4	5
Total interest-earning assets	3,984	(3,484)	500
Interest expense:			
Deposits	804	(808)	(4)
Borrowings from the FHLB	(52)	(67)	(119)
Total interest-bearing liabilities	752	(875)	(123)
Net change in net interest income	\$3,232	\$(2,609)	\$623

- (1) Tax equivalent adjustments to interest on investment securities were \$185,000 and \$193,000 for the quarters ended September 30, 2013 and 2012, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

**Total Interest Income.** Total interest income, on a taxable equivalent basis, increased by \$500,000, or 6.5%, to \$8.1 million for the quarter ended September 30, 2013 compared with the third quarter of 2012. Interest income from loans receivable increased by \$511,000, the result of a \$95.2 million increase in the average balance of loans outstanding netted against the effect of a decrease in the average yield on loans of 43 basis points. The merger with Roebing resulted in the increase in the average balance of loans outstanding whereas the decrease in the yield was caused by the combined effects of a large number of higher rate loans being prepaid, and new loans added to the portfolio with lower yields than the existing portfolio loans that had matured or refinanced. Interest income from mortgage-backed securities was lower in the quarter ended September 30, 2013 in comparison to the same period in 2012 mainly because the yield associated with principal repayments and sales which occurred during the intervening period was higher than the yield on the remaining mortgage-backed securities as well as the low yield on the mortgage-backed securities acquired from Roebing. Interest income from investment securities increased during the third quarter of 2013 as compared with the third quarter of 2012 due to the higher outstanding average balance of agency securities acquired from Roebing as well as purchases of municipal securities during the intervening period. Offsetting the increase in balance was the effect of lower yields on the securities acquired from Roebing.

**Total Interest Expense.** Total interest expense decreased by \$123,000 to \$1.0 million, during the three-month period ended September 30, 2013 as compared with the same period in 2012. Interest expense incurred on deposits was largely unchanged between the periods. The average balance outstanding on deposits increased \$153.0 million

between the third quarters of 2013 and 2012 mainly as a result of the Roebing acquisition. The average interest rate paid on the Bank's deposits was 13 basis points lower in 2013 due to the maturity of certificates of deposit with higher interest rates than current market rates offered on the products into which the maturing CDs were renewed or reinvested, and a favorable change in the deposit mix and pricing. Interest expense associated with borrowings from the FHLB decreased \$119,000 in the third quarter of 2013 as compared to the same quarter of 2012. During the intervening period, the Bank decreased its average outstanding borrowings by \$11.4 million and because the remaining advances had rates lower than the maturing advances, a decrease in the cost of borrowed funds of 53 basis points resulted.

Table of Contents

Noninterest Income. Total noninterest income was \$2.0 million for the third quarter of 2013 compared with \$914,000 for the same period in 2012. Purchase gain associated with the acquisition of Roebling totaled \$1.2 million. Fair value adjustments to mortgage servicing rights increased loan servicing income by \$85,000 during the third quarter of 2013 compared to the same quarter of 2012.

Noninterest Expense. Total noninterest expense increased by \$2.3 million to \$6.8 million for the three months ended September 30, 2013 compared to the same period in 2012. Acquisition costs attributable to Roebling totaled \$1.4 million during the third quarter of 2013 and included contract exit fees as well as technology related costs and consultant fees incurred for the system conversion of the data from Roebling to the Bank. Employee compensation increased by \$474,000 in 2013, mainly the result of employee costs associated with staffing the five additional branches acquired from Roebling. In addition, stock option expense for option grants increased \$80,000 in the third quarter of 2013 over the same period in 2012. Occupancy costs increased \$181,000 in the third quarter of 2013 is the result of operating and maintaining the five additional branch offices acquired from Roebling.

Income Tax Expense. The Company's effective tax rate was 8.5% for the quarter ended September 30, 2013 compared to 24.5% for the quarter ended September 30, 2012. These effective tax rates are lower than the Company's marginal tax rate of 34% largely due to the tax-exempt income associated with the Company's investments in tax-exempt municipal bonds, bank owned life insurance and purchase gain associated with the Roebling acquisition.

Table of Contents

## RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013 AND 2012

Net Income. The Company recorded net income of \$5.0 million, or \$1.75 per diluted share, for the nine months ended September 30, 2013 as compared to net income of \$3.9 million, or \$1.42 per diluted share, for the nine months ended September 30, 2012.

## Average Balance Sheet

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

	Nine Months Ended September 30,						Average yld/cost	
	Average balance	2013 Interest	Average yld/cost		Average balance	2012 Interest		
<b>ASSETS</b>								
Interest-earning assets:								
Loans receivable(1)	\$557,829	\$18,976	4.55	%	\$507,521	\$18,864	4.96	%
Mortgage-backed securities	43,448	841	2.59	%	59,776	1,556	3.48	%
Investment securities(2)	73,508	2,229	4.05	%	66,498	2,154	4.33	%
Other interest-earning assets(3)	34,451	23	0.09	%	5,676	2	0.05	%
Total interest-earning assets	709,236	22,069	4.16	%	639,471	22,576	4.72	%
Noninterest-earning assets	46,974				48,345			
Total assets	\$756,210				\$687,816			
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>								
Interest-bearing liabilities:								
Deposits	\$609,531	\$2,242	0.49	%	\$547,700	\$2,795	0.68	%
Borrowings from the FHLB	54,922	693	1.69	%	53,685	1,094	2.72	%
Total interest-bearing liabilities	664,453	2,935	0.59	%	601,385	3,889	0.86	%
Noninterest-bearing liabilities	6,746				6,732			
Total liabilities	671,199				608,117			
Stockholders' equity	85,011				79,699			
Total liabilities and stockholders' equity	\$756,210				\$687,816			
Net interest income—tax equivalent basis		19,134				18,687		
Interest rate spread(4)—tax equivalent basis			3.57	%			3.86	%
Net yield on interest-earning assets(5)—tax equivalent basis			3.61	%			3.90	%
Ratio of average interest-earning assets to average interest-bearing liabilities			106.74	%			106.33	%
Less: tax-equivalent interest adjustments		(565 )				(590 )		
Net interest income		\$18,569				\$18,097		
Interest rate spread(4)			3.46	%			3.73	%

Net yield on interest-earning assets(5)	3.50	%	3.78	%
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- (1) Nonperforming loans have been included in the appropriate average loan balance category, but interest on nonperforming loans has not been included for purposes of determining interest income.
- (2) Tax equivalent adjustments to interest on investment securities were \$565,000 and \$590,000 for the nine months ended September 30, 2013 and 2012, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.
- (3) Includes interest-bearing deposits in other banks.
- (4) Interest rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.  
Net yield on interest-earning assets represents net interest income as a percentage of average
- (5) interest-earning assets.

Table of Contents

## Rate/Volume Analysis

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

	For the nine months ended September 30, 2013 vs 2012		
	Volume	Rate	Net
Interest income:			
Loans receivable, net	\$2,308	\$(2,196 )	\$112
Mortgage-backed securities	(371 )	(344 )	(715 )
Investment securities (1)	268	(193 )	75
Other interest-earning assets	18	3	21
Total interest-earning assets	2,223	(2,730 )	(507 )
Interest expense:			
Deposits	437	(990 )	(553 )
Borrowings from the FHLB	40	(441 )	(401 )
Total interest-bearing liabilities	477	(1,431 )	(954 )
Net change in net interest income	\$1,746	\$(1,299 )	\$447

- (1) Tax equivalent adjustments to interest on investment securities were \$565,000 and \$590,000 for the nine months ended September 30, 2013 and 2012, respectively. Tax equivalent interest income is based upon a marginal effective tax rate of 34%.

**Total Interest Income.** Total interest income, on a taxable equivalent basis, decreased by \$507,000 or 2.2%, to \$22.1 million for the nine months ended September 30, 2013 compared with the same period of 2012. Interest income from loans receivable increased by \$112,000 as the result of a \$50.4 million increase in the average balance of loans outstanding netted against the effect of a decrease in the average yield on loans of 40 basis points. The merger with Roebing resulted in the increase in the average balance of loans outstanding whereas the decrease in the yield was caused by the combined effects of a large number of higher rate loans being prepaid, and new loans added to the portfolio with lower yields than the existing portfolio loans that had matured or refinanced. Interest income from mortgage-backed securities was lower in the nine months ended September 30, 2013 in comparison to the same period in 2012 mainly because the yield associated with principal repayments and sales which occurred during the intervening period was higher than the yield on the remaining mortgage-backed securities as well as the low yield on the mortgage-backed securities acquired from Roebing. Interest income from investment securities increased during the nine months ended September 30, 2013 as compared with the same period in 2012 due to the higher outstanding average balance of agency securities acquired from Roebing as well as purchases of municipal securities during the intervening period. Offsetting the increase in balance was the effect of lower yields on the securities acquired from Roebing.

**Total Interest Expense.** Total interest expense decreased by \$954,000 to \$2.9 million during the nine-month period ended September 30, 2013 as compared with the same period in 2012. The average outstanding balance of deposits

increased \$61.8 million during the first nine months of 2013 as compared to the same period in 2012 mainly as a result of the Roebing acquisition. The average interest rate paid on the Bank's deposits was 19 basis points lower in 2013 due to the maturity of certificates of deposit with higher interest rates than current market rates offered on the products into which the maturing CDs were renewed or reinvested, and a favorable change in the deposit mix and pricing. Interest expense associated with borrowings from the FHLB decreased \$401,000 in the first nine months of 2013 when compared to the same period of 2012. During the intervening period, the average outstanding borrowings increased only by \$1.2 million, however new advances had rates lower than the maturing advances, resulting in a decrease in the cost of borrowed funds of 103 basis points between the periods.

Noninterest Income. Total noninterest income was \$5.4 million for the first nine months of 2013 compared with \$2.9 million for the same period in 2012. Purchase gain associated with the acquisition of Roebing totaled \$1.2 million. In addition, income from the benefits paid on the bank owned life insurance policies was \$934,000 during the second quarter of 2013 due to the death of two insured individuals. Fair value adjustments to mortgage servicing rights increased loan servicing income by \$349,000 during the first nine months of 2013 compared to the same time period of 2012. Gain on disposition of premises and equipment



## Table of Contents

included \$417,000 related to an eminent domain matter affecting a parcel of Company property, a \$143,000 increase over the amount recorded in 2012 related to the same matter, which is now finalized. Offsetting these increases was a decrease in the gain on sale of loans in the secondary market of \$285,000.

**Noninterest Expense.** Total noninterest expense increased by \$2.8 million to \$16.9 million for the nine months ended September 30, 2013 compared to the same period in 2012. Acquisition costs attributable to Roebbling totaled \$1.4 million during the third quarter of 2013 and included contract exit fees as well as technology related costs and consultant fees incurred for the system conversion of the data from Roebbling to the Bank. Professional merger-related costs attributable to the acquisition of Roebbling totaled \$617,000 during the first nine months of 2013. Employee compensation increased by \$562,000 in 2013, mainly the result of employee costs associated with staffing the five additional branches acquired from Roebbling. In addition, stock option expense for option grants increased \$209,000 for the nine months ended September 2013 over the same period in 2012. The occupancy costs increased \$205,000 in the third quarter of 2013 is largely the result of operating and maintaining the five additional branch offices acquired from Roebbling.

**Income Tax Expense.** The Company's effective tax rate was 19.2% for the nine months ended September 30, 2013 compared to 23.5% for the nine months ended September 30, 2012. These effective tax rates are lower than the Company's marginal tax rate of 34% largely due to the tax-exempt income associated with the Company's investments in tax-exempt municipal bonds, bank owned life insurance and purchase gain associated with the Roebbling acquisition offset by merger-related costs treated as nondeductible.

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

The Bank's liquidity is a measure of its ability to fund loans, and pay withdrawals of deposits, and other cash outflows in an efficient, cost-effective manner. The Bank's short-term sources of liquidity include maturities, repayment and sales of assets, excess cash and cash equivalents, new deposits, brokered deposits, other borrowings, and new borrowings from the Federal Home Loan Bank and the Federal Reserve Bank. There has been no material adverse change during the nine-month period ended September 30, 2013 in the ability of the Bank and its subsidiaries to fund their operations.

At September 30, 2013, the Bank had commitments outstanding under letters of credit of \$856,000, commitments to originate loans of \$13.6 million, and commitments to fund undisbursed balances of closed loans and unused lines of credit of \$54.9 million. At September 30, 2013, the Bank had \$3.1 million in outstanding commitments to sell loans. There has been no material change during the nine months ended September 30, 2013 in any of the Bank's other contractual obligations or commitments to make future payments.

The Company's primary sources of liquidity are dividends from the Bank, principal and interest payments received from a loan made to the Bank's ESOP, and tax benefits arising from the use of the Company's tax deductions by other members of its consolidated group pursuant to a tax sharing agreement. The Company is dependent upon these sources and cash on hand which totaled approximately \$2.5 million at September 30, 2013 in order to fund its operations and pay the dividend to its shareholders. There has been no material adverse change in the ability of the Company to fund its operations during the nine-month period ended September 30, 2013.

### Capital Requirements

The Bank was in compliance with all of its capital requirements as of September 30, 2013.

## CRITICAL ACCOUNTING POLICIES

Certain critical accounting policies of the Company require the use of significant judgment and accounting estimates in the preparation of the consolidated financial statements and related data of the Company. These accounting estimates require management to make assumptions about matters that are highly uncertain at the time the accounting estimate is made. Management believes that the most critical accounting policy requiring the use of accounting estimates and judgment is the determination of the allowance for loan losses. If the financial position of a significant number of debtors or the value of the collateral securing the loans should deteriorate more than the Company has estimated, the present allowance for loan losses may be insufficient and additional provisions for loan losses may be required. The allowance for loan losses was approximately \$6.7 million at September 30, 2013.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Controls over Financial Reporting

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

Table of Contents

## TF FINANCIAL CORPORATION AND SUBSIDIARIES

## PART II-OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

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

## ITEM 1A. RISK FACTORS

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

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information on repurchases by the Company of its common stock in each month for the three months ended September 30, 2013:

Month	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
July 1, 2013 - July 31, 2013	—	—	—	101,957
August 1, 2013 - August 31, 2013	1,200	\$ 27.37	1,200	100,757
September 1, 2013 - September 30, 2013	1,405	\$ 27.41	1,405	99,352
Quarterly total	2,605	\$ 27.39	2,605	

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

## ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

Table of Contents

TF FINANCIAL CORPORATION

SIGNATURES

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

Date: November 13, 2013

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

Date: November 13, 2013

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