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HARLEYSVILLE SAVINGS FINANCIAL CORP

Form 10-K

December 23, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended: September 30, 2003

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

Commission File Number: 0-29709

HARLEYSVILLE SAVINGS FINANCIAL CORPORATION
(Exact name of Registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction
of incorporation or organization)

23-3028464
(I.R.S. Employer
Identification Number)

271 Main Street
Harleysville, Pennsylvania
(Address of principal executive offices)

19438
(Zip Code)

Registrant's telephone number, including area code: (215) 256-8828

Common Stock, \$.01 par value
Title of Class

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 and (2) has been subject to such filing requirements for the past 90 days. YES NO

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES NO

The aggregate market value of the 1,817,903 shares of the Registrant's Common Stock held by non-affiliates (2,316,490 shares outstanding less 498,587 shares held by affiliates), based upon the closing price of \$25.53 for the Common Stock on March 31, 2003, as reported by the Nasdaq Stock Market, was approximately \$46.4 million. Shares of Common Stock held by each executive officer and director and by each person who owns 5% or more of the outstanding Common Stock

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have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Number of shares of Common Stock outstanding as of December 5, 2003: 2,316,490

DOCUMENTS INCORPORATED BY REFERENCE

Set forth below are the documents incorporated by reference and the part of the Form 10-K into which the document is incorporated:

- (1) Portions of the Annual Report to Stockholders for the year ended September 30, 2003 are incorporated by reference into Part II, Items 5-8 and Part IV, Item 15 of this Form 10-K.
- (2) Portions of the definitive Proxy Statement for the 2004 Annual Meeting of Stockholders are incorporated by reference into Part III, Items 10-13 of this Form 10-K.

Forward-Looking Statements

In the normal course of business, the Company, in an effort to help keep its stockholders and the public informed about the Company's operations, may from time to time issue or make certain statements, either in writing or orally, that are or contain forward-looking statements, as that term is defined in the federal securities laws. Generally, these statements relate to business plans or strategies, projected or anticipated benefits from potential acquisitions, projections involving anticipated revenues, earnings, profitability or other aspects of operating results or other future developments in the affairs of the Company or the industry in which it conducts business. These forward-looking statements, which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods or by the use of forward-looking terminology such as "anticipate," "believe," "commitment," "consider," "continue," "could," "encourage," "estimate," "expect," "intend," "in the event of," "may," "plan," "present," "propose," "prospect," "update," "whether," "will," "would," future or conditional verb tenses, similar terms, variations on such terms or negatives of such terms. Although the Company believes that the anticipated results or other expectations reflected in such forward-looking statements are based on reasonable assumptions, it can give no assurance that those results or expectations will be attained. Actual results could differ materially from those indicated in such statements due to risks, uncertainties and changes with respect to a variety of factors, including, but not limited to, the following: competitive pressure among depository and other financial institutions may increase significantly; changes in the interest rate environment may reduce interest margins and net interest income, as well as adversely affect loan originations and sales activities and the value of certain assets, such as investment securities; general economic or business conditions, either nationally or in regions in which the Company does business, may be less favorable than expected, resulting in, among other things, a deterioration in credit quality or a reduced demand for credit; legislation or changes in regulatory requirements, including without limitation, capital requirements, or accounting standards may adversely affect the Company and the business in which it is engaged; adverse changes may occur in the securities markets; competitors of the company may have greater financial resources and develop products and technology that enable those competitors to compete more successfully than the company; and the growth and profitability of the Company's noninterest income may be less than expected.

The Company undertakes no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report on

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Form 10-K.

As used in this report, unless the context otherwise requires, the terms "we," "us," or the "Company" refer to Harleystville Savings Financial Corporation, a Pennsylvania corporation, and the term the "Bank" refers to Harleystville Savings Bank, a Pennsylvania chartered savings bank and wholly owned subsidiary of the Company. In addition, unless the context otherwise requires, references to the operations of the Company include the operations of the Bank.

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PART I

Item 1. Business.

General

Harleystville Savings Financial Corporation is a Pennsylvania corporation headquartered in Harleystville, Pennsylvania. The Company became the bank holding company for Harleystville Savings Bank in connection with the holding company reorganization of the Bank in February 2000 (the "Reorganization"). In August 1987, the Bank's predecessor, Harleystville Savings Association, converted to the stock form of organization. The Bank, whose predecessor was originally incorporated in 1915, converted from a Pennsylvania chartered, permanent reserve fund savings association to a Pennsylvania chartered stock savings bank in June 1991. The Bank operates from five full-service offices located in Montgomery County, Pennsylvania. The Bank's primary market area includes Montgomery County, which has the third largest population and the second highest per capita income in the Commonwealth of Pennsylvania, and, to a lesser extent, Bucks County. As of September 30, 2003, the Company had \$653,288 million of total assets, \$380,687 million of deposits and \$40,816 million of stockholders' equity. The Company's stockholders' equity constituted 6.25% of total assets as of September 30, 2003.

The Bank's primary business consists of attracting deposits from the general public through a variety of deposit programs and investing such deposits principally in first mortgage loans secured by residential properties in the Bank's primary market area. The Bank also originates a variety of consumer loans, predominately home equity loans and lines of credit also secured by residential properties in the Bank's primary lending area. The Bank serves its customers through its full-service branch network as well as through remote ATM locations, the internet and telephone banking.

Deposits with the Bank are insured to the maximum extent provided by law through the Savings Association Insurance Fund ("SAIF") administered by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to examination and comprehensive regulation by the FDIC and the Pennsylvania Department of Banking ("Department"). It is also a member of the Federal Home Loan Bank of Pittsburgh ("FHLB of Pittsburgh" or "FHLB"), which is one of the 12 regional banks comprising the Federal Home Loan Bank System ("FHLB System"). The Bank is also subject to regulations of the Board of Governors of the Federal Reserve System ("Federal Reserve Board") governing reserves required to be maintained against deposits and certain other matters.

The Company's principal executive offices are located at 271 Main Street, Harleystville, Pennsylvania 19438 and its telephone number is (800) 243-8700.

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Lending Activities

Loan Portfolio Composition. The Company's loan portfolio is predominantly comprised of loans secured by first mortgages on single-family residential properties. As of September 30, 2003, first mortgage loans on residential properties, including loans on single-family and multi-family residential properties and construction loans on such properties, amounted to \$246.3 million or 45.7% of the Company's total loan and mortgage-backed securities portfolio. Loans on the Company's residential properties are primarily long-term and are conventional (i.e., not insured or guaranteed by a federal agency). At September 30, 2003, mortgage-backed securities totaled \$230.2 million and comprised 42.6% of the portfolio.

As of September 30, 2003, loans secured by commercial real estate comprised \$1.0 million or 0.2% of the total loan and mortgage-backed securities portfolio. Consumer loans, including installment home equity loans, home equity lines of credit, automobile loans, loans on savings accounts and education loans, constituted \$60.5 million or 11.2% of the total loan and mortgage-backed securities portfolio as of September 30, 2003.

As of September 30, 2003, the Company had \$230.2 million, or 42.6%, of the total portfolio invested in Federal Home Loan Mortgage Corporation ("FHLMC"), Government National Mortgage Association ("GNMA") or Federal National Mortgage Association ("FNMA") backed securities. FHLMC securities are guaranteed by the FHLMC, GNMA securities by the Federal Housing Administration and FNMA securities by the FNMA, which are an instrumentality of the United States government, and, pursuant to federal regulations, are deemed to be part of the Company's loan portfolio.

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The following table sets forth information concerning the Company's loan and mortgage-backed securities portfolio by type of loan at the dates indicated.

	As of September 30,				
	2003		2002		
	Amount	Percent	Amount	Percent	

	(Dollars in Thousands)				
Real estate loans:					
Residential:					
Single-family	\$234,748	43.6%	\$233,057	46.7%	\$230
Multi-family	1,515	0.3	1,056	0.2	
Construction	10,028	1.9	8,607	1.7	14
Lot loans	923	0.2	1,247	0.2	1
Mortgage-backed securities	230,247	42.6	193,330	38.8	167
Commercial	1,015	0.2	496	0.1	
	-----	-----	-----	-----	-----
Total real estate loans and mortgage-backed securities	478,476	88.8%	437,793	87.7%	416
	-----	-----	-----	-----	-----
Consumer loans:					
Education loans	1	0.0%	334	0.1%	1

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Installment equity loans	29,726	5.5	41,451	8.3	43
Line of credit loans	29,420	5.5	18,530	3.7	9
Savings account loans	733	0.1	479	0.1	
Automobile and other loans	578	0.1	726	0.1	
	-----	-----	-----	-----	-----
Total consumer loans	60,458	11.2%	61,520	12.3%	55
Total loans receivable and mortgage-backed securities	538,934	100.0%	499,313	100.0%	471
	-----	-----	-----	-----	-----
Less:					
Loans in process	(7,829)		(6,503)		(9)
Deferred loan fees	(1,520)		(2,091)		(2)
Allowance for loan losses	(1,991)		(2,035)		(2)
	-----		-----		-----
Total loans receivable and mortgage-backed securities, net	\$527,594		\$488,684		\$457
	=====		=====		=====

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Contractual Maturities. The following table sets forth scheduled contractual maturities of the loan and mortgage-backed securities portfolio of the Company as of September 30, 2003 by categories of loans and securities. The principal balance of the loan is set forth in the period in which it is scheduled to mature. This table does not reflect loans in process or unamortized premiums, discounts and fees.

	Principal Balance at September 30, 2003	Principal Repayments Contractually Due in Years(s) Ended September 3			
		2004	2005	2006 - 2007	2008 - 2013
	-----	-----	-----	-----	-----
				(In Thousands)	
Real estate loans:					
Residential					
Single-family	\$234,748	\$ 3,521	\$ 3,756	\$ 12,676	\$ 28,874
Multi-family	1,515	23	24	82	186
Construction	10,028	150	160	542	1,233
Lot loans	923	50	54	186	418
Mortgage-backed securities	230,247	3,454	3,914	12,894	29,011
Commercial	1,015	37	40	139	322
Consumer and other loans	60,458	7,436	7,980	27,675	13,603
	-----	-----	-----	-----	-----
Total (1)	\$538,934	\$ 14,671	\$ 15,928	\$ 54,198	\$ 73,647
	=====	=====	=====	=====	=====

(1) With respect to the \$524.3 million of loans with principal maturities contractually due after September 30, 2004, \$375.5 million have fixed

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rates of interest and \$148.8 million have adjustable or floating rates of interest.

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Contractual principal maturities of loans do not necessarily reflect the actual term of the Company's loan portfolio. The average life of mortgage loans is substantially less than their contractual terms because of loan payments and prepayments and because of enforcement of due-on-sale clauses, which give the Company the right to declare a loan immediately due and payable in the event, among other things, that the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase when current mortgage loan rates substantially exceed rates on existing mortgage loans and, conversely, decrease when rates on existing mortgage loans substantially exceed current mortgage loan rates.

Interest rates charged by the Company on loans are affected principally by the demand for such loans and the supply of funds available for lending purposes. These factors are, in turn, affected by general economic conditions, monetary policies of the federal government, including the Federal Reserve Board, legislative tax policies and government budgetary matters. The interest rates charged by the Company are competitive with those of other local financial institutions.

Origination, Purchase and Sale of Loans. Although the Company has general authority to originate, purchase and sell loans secured by real estate located throughout the United States, the Company's lending activities are focused in its assessment area of Montgomery County, Pennsylvania and surrounding suburban counties.

The Company accepts loan applications through its branch network, and also accepts mortgage applications from mortgage brokers who are approved by the Board of Directors to do business with the Company.

The Company generally does not engage in the purchase of whole loans or loan participations.

During the year ended September 30, 2003, the Company sold \$13.0 million of mortgage-backed securities for a gain of \$159,000. During the year ended September 30, 2002, the Company did not sell any mortgage-backed securities. The Company sold \$7.3 million of mortgage-backed securities during the year ended September 30, 2001 for a gain of \$151,663. The Company sold \$1.4 million, \$2.5 million and \$3.3 million of loans during fiscal 2003, 2002 and 2001, resulting in a gain of \$15,581, \$31,132 and \$39,647, respectively.

The Company's total loan originations increased by \$42.1 million or 34.9% in fiscal 2003 and increased by \$12.5 million or 11.6% in fiscal 2002. Of the \$169.8 million and \$86.0 million of single-family loans originated in fiscal 2003 and 2002, \$67.8 million and \$23.1 million, respectively, were loans originated to refinance property, \$102.0 million and \$62.9 million, respectively, were loans to acquire residential property. During this period, the Company's originations of consumer loans amounted to \$46.3 million and \$53.4 million or 28.6% and 41.5% of total loan originations during fiscal 2003 and 2002,

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respectively. Management intends to continue to emphasize origination of

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consumer loans which may have adjustable rates, and generally have shorter terms than residential real estate loans.

The following table shows total loans originated, sold and repaid during the periods indicated.

	Year Ended September 30,		
	2003	2002	2001
	(In Thousands)		
Real estate loan originations:			
Residential:			
Single-family	\$102,712	\$ 62,939	\$ 55,07
Multi-family	1,380	266	-
Construction	12,007	11,224	20,90
Lot loans	109	815	69
	-----	-----	-----
Total real estate loan originations	116,208	75,244	76,67
Consumer loan originations(1)	46,288	45,255	31,30
	-----	-----	-----
Total loan originations	162,496	120,499	107,98
Purchases of mortgage-backed securities	277,885	87,280	80,17
	-----	-----	-----
Total loan originations, and purchases	440,381	207,779	188,16
Principal loan and mortgage-backed securities repayments	386,359	170,574	106,52
Sales of loans and mortgage-backed securities	14,401	9,840	10,60
	-----	-----	-----
Total principal repayments and sales	400,760	180,414	117,12
	-----	-----	-----
Net increase in loans	\$ 39,621	\$ 27,365	\$ 71,03
	=====	=====	=====

 (1) Includes installment home equity loans, home equity lines of credit, vehicle loans, Pennsylvania Higher Education Assistance loans, secured and unsecured personal loans and lines of credit.

Loan Underwriting Policies. Each loan application received by the Company is underwritten to the standards of the Company's written underwriting policies as adopted by the Company's Board of Directors. The Company's Board of Directors has granted loan approval authority to several officers and employees of the Company, provided that the loan meets the guidelines set out in its written underwriting policies. Individual approval authority of \$500,000 has been granted to the Company's Chief Executive Officer, the Company's President, and the Company's Chief Lending Officer. Joint approval authority of \$1.0 million has been granted to a combination of at least two of the above named individuals. Individual lending authority of \$250,000 has been granted to the Bank's Assistant Vice President/Loan Administration Manager, the Assistant Vice President/Loan Customer Service Manager and to the Bank's Consumer Loan and Residential Mortgage Underwriter, employed by the Company. Additional consumer loan lending authority of \$50,000 has been granted to several delegated underwriters, employed by the Bank. All approved loans are ratified by the Board of Directors at the next succeeding board meeting. Any loan which does not meet the guidelines set forth in the lending policies must be approved by the Company's Board of Directors.

In the exercise of any loan approval authority, the officers of the Company will take into account the risk associated with the extension of credit to a single borrower, borrowing entity, or affiliation. The Company has an aggregate loans to one borrower limit of 15% of the Company's unimpaired capital and unimpaired surplus in accordance with federal regulations. At September 30, 2003, the largest aggregate amount of loans outstanding to any borrower, including related entities, was \$2.1 million, which did not exceed the Company's loan to one borrower limitation.

Real Estate Lending. The Company is permitted to lend up to 100% of the appraised value of the real property securing a loan. The Company will generally lend up to 95% of the lesser of the appraised value or the sale price for the purchase of single-family, owner-occupied dwellings which conform to the secondary market underwriting standards. Refinancings are limited to 90% or less. Loans over \$300,700 and other non-conforming loans, secured by 1-4 residential, owner-occupied dwellings, are limited to 90% of the lesser of the purchase price or appraised value. The purchase of non-owner occupied, 1-4 unit dwellings may be financed to 80% of the lower of the appraisal or sale price; a refinance is limited to 75% of the appraised value.

All appraisals and other property valuations are performed by independent fee appraisers approved by the Company's Board of Directors. On all real estate loans, other than certain "streamlined refinances," the Company requires borrowers to obtain title insurance, insuring the Company has a valid first lien on the mortgaged real estate. Borrowers must also obtain and maintain a hazard insurance policy prior to closing and, when the real estate is located in a flood hazard area designated by the Federal Emergency Management Agency, a flood insurance policy is required. Generally, borrowers advance funds on a monthly basis together with payment of principal and interest into a mortgage escrow account from which the Company makes disbursements for items such as real estate taxes and insurance premiums when appropriate as they fall due.

The Company presently originates fixed-rate loans on single-family residential properties pursuant to underwriting standards consistent with secondary market guidelines, and which may or may not be sold into the secondary mortgage market as conditions warrant. Adjustable rate mortgages ("ARMs"), as well as non-conforming and jumbo fixed-rate loans in amounts up to \$1.0 million, are held in the portfolio. It is the Company's policy to originate both fixed-rate loans and ARMs for terms up to 30 years. As of September 30, 2003, \$247.7 million or 45.8% and \$1.5 million or 0.3% of the Company's total loan and mortgage-backed securities portfolio consisted of single-family (including construction loans) and multi-family residential loans, respectively. As of September 30, 2003, approximately \$434.5 million or 90.3% of the Company's total mortgage loans and mortgage-backed securities portfolio consisted of fixed-rate, single-family residential mortgage loans. As of such date, \$44.0 million or 9.1% of the total mortgage loan portfolio consisted of adjustable-rate single-family residential mortgage loans and mortgage-backed securities. Most of the Company's residential mortgage loans include "due on sale" clauses.

During the year ended September 30, 2003, the Company originated \$1.2 million of ARM mortgages. ARMs represented 1.1% and 2.2% of the Company's total mortgage loan portfolio originations in fiscal 2003 and 2002, respectively. The ARM mortgages offered by the Company are originated with initial adjustment periods varying from one to 10 years, and provide for initial rates of interest

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below the rates which would prevail were the index used for repricing applied initially. The Company expects to emphasize the origination of ARMs as market conditions permit, in order to reduce the impact of rising interest rates in the market place. Such loans, however, may not adjust as rapidly as changes in the Company's cost of funds.

The Company also originates, to a lesser extent, loans secured by multi-family rental units or properties with some commercial usage. The primary method used by the Company to evaluate a multi-family residential or commercial mortgage loan is based on both the fair market value of the property and an income approach pursuant to which the Company determines if the income from the project will be sufficient to support the related debt and other associated costs. The Company also considers a review of the costs to develop the project and the overall financial strength of the borrower. Multi-family residential loans are made on an adjustable rate basis for a maximum term of 25 years or a fixed rate of 15 years or less.

Construction Loans. The Company offers fixed-rate and adjustable-rate construction loans on residential properties. Residential construction loans are originated for individuals who are building their primary residence as well as to selected local builders for construction of single-family dwellings. As of September 30, 2003, \$10.0 million or 1.9% of the total loan and mortgage-backed securities portfolio consisted of construction loans.

Construction loans to homeowners are usually made in connection with the permanent financing on the property. The permanent loans have amortizing terms up to 30 years, following the initial construction phase during which time the borrower pays interest on the funds advanced. These loans are reclassified as permanent mortgage loans when the residences securing the loans are completed. The Company will make construction/permanent loans up to a maximum of 90% of the fair market value of the completed project. The rate on the loan during construction is the same rate as the Company will charge on the permanent loan on the completed project. Advances are made on a percentage of completion basis with the Company's receipt of a satisfactory inspection report of the project.

Historically, the Company has been active in on-your-lot home construction lending and intends to continue to emphasize such lending. Although construction lending is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate, the Company historically has not experienced any significant problems.

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The Company also offers mortgage loans on undeveloped single lots held for residential construction. These loans are generally fixed-rate loans with terms not exceeding 15 years; they are not a significant part of the Company's lending activities.

Consumer and Other Loans. The Company actively originates consumer loans to provide a wider range of financial services to its customers and to improve the interest rate sensitivity of its interest-earning assets. Originations of consumer loans as a percent of total loan originations amounted to 28.6% and 41.5% during fiscal 2003 and 2002, respectively. The shorter-term and normally higher interest rates on such loans help the Company to maintain a profitable spread between its average loan yield and its cost of funds. The Company's consumer loan department offers a variety of loans, including home equity installment loans and lines of credit, vehicle loans, personal loans and lines of credit. Loans secured by deposit accounts at the Company are also made to depositors in an amount up to 90% of their account balances with terms of up to 15 years.

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Home equity loans continue to be a popular product and represented \$59.1 million or 10.9% of the loan and mortgage-backed securities portfolio at September 30, 2003. After taking into account first mortgage balances, the Company will lend up to 80% of the value of owner-occupied property on fixed rate terms up to 15 years. This amount may be raised to 100% when considering other factors, such as excellent credit history and income stability. At September 30, 2003, the Company had outstanding 2,495 home equity loans of which 1,192 were installment equity loans and 1,303 were line of credit loans. As of such date, the Company had an outstanding balance on line of credit loans of approximately \$29.4 million and there was approximately \$33.0 million of unused credit available on such loans.

Consumer loans generally involve more risk of collectibility than mortgage loans because of the type and nature of the collateral and, in certain cases, the absence of collateral. As continued payments are dependent on the borrower's continuing financial stability, these loans may be more likely to be adversely affected by job loss, divorce, personal bankruptcy or by adverse economic conditions.

Loan Fee and Servicing Income. The Company receives fees both for the origination of loans and for making commitments to originate and purchase residential and commercial mortgage loans. The Company also receives servicing fees with respect to residential mortgage loans it has sold. It also receives loan fees related to existing loans, including late charges, and credit life insurance premiums. Loan origination and commitment fees and discounts are a volatile source of income, varying with the volume and type of loans and commitments made and purchased and with competitive and economic conditions.

Loans fees generated on origination of real estate mortgage loans under accounting principles generally accepted in the United States of America are deferred to the extent that they exceed the costs of originating such loans. Deferred loan fees and discounts on mortgage loans purchased are amortized to income over the estimated remaining terms of such loans using various methods which approximate the

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interest method. The Company generated \$1.6 million, \$635,000 and \$268,000 in deferred loan fees in fiscal 2003, 2002 and 2001, respectively.

In its real estate lending, the Company charges loan fees which are calculated as a percentage of the amount borrowed. The fees received in connection with the origination of residential real estate loans and commercial real estate loans generally do not exceed 3% of the principal amount. All origination fees in excess of loan origination costs are deferred and amortized into income over the estimated life of the related loans.

As of September 30, 2003, the Company was servicing \$2.6 million of loans for others, substantially all of which related to loans sold by the Company to the FHLMC. The Company receives a servicing fee of 0.25% on such loans.

Non-performing Loans and Real Estate Owned. When a borrower fails to make a required loan payment, the Company attempts to cure the default by contacting the borrower; generally, after a payment is more than 15 days past due, at which time a late charge is assessed. Defaults are cured promptly in most cases. If the delinquency on a mortgage loan exceeds 60 days and is not cured through the Company's normal collection procedures, or an acceptable arrangement is not worked out with the borrower, the Company will institute measures to remedy the default. This may include commencing a foreclosure action or, in special

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circumstances, accepting from the borrower a voluntary deed of the secured property in lieu of foreclosure with respect to mortgage loans and equity loans, or title and possession of collateral in the case of other consumer loans. Substantial delays may occur in instituting and completing residential foreclosure proceedings due to the extensive procedures and time periods required to be complied with under Pennsylvania law.

All interest accrued but not collected for loans that are placed nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Interest income is recognized using the interest method when the collection is reasonably assured. The Company had no loans outstanding which were recorded as loans accounted for on a non-accrual basis as of the end of the period.

If foreclosure is effected, the property is sold at a public auction in which the Company may participate as a bidder. If the Company is the successful bidder, the acquired real estate property is then included in the Company's "real estate owned" ("REO") account until it is sold. When property is acquired, it is recorded at the lower of carrying or market value at the date of acquisition and any write-down resulting is reclassified to the allowance for loan losses. Interest accrual, if any, ceases on the date of acquisition and all costs incurred in maintaining the property from that date forward are expended. Costs incurred for the improvement or development of such property are capitalized. The Company is

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permitted under Department regulations to finance sales of real estate owned by "loans to facilitate," which may involve more favorable interest rates and terms than generally would be granted under the Company's underwriting guidelines. The Company had no REO at the end of the period.

The following table sets forth information regarding non-accrual loans, loans which are 90 days or more delinquent but on which the Company is accruing interest, troubled debt restructuring, and other real estate owned held by the Company at the dates indicated. The Company continues to accrue interest on loans which are 90 days or more overdue where management believes that such interest is collectible.

	As of September 30,	
	2003	2002
	----	----
	(Dollars in Thousands)	
Residential real estate loans:		
Non-accrual loans	\$ --	\$ --
Accruing loans 90 days overdue	273	167
Troubled debt restructurings	--	--
	----	----
Total	273	167
	----	----
Consumer loans:		
Non-accrual loans	--	--

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Accruing loans 90 days overdue	--	--
Troubled debt restructurings	--	--
	----	----
Total	--	--
	----	----
Total non-performing loans:		
Non-accrual loans	--	--
Accruing loans 90 days overdue	273	167
Troubled debt restructurings	--	--
	----	----
Total	\$273	\$167
	====	====
Total non-performing loans to total loans	.09%	.05%
Total other real estate owned, net of related reserves	--	--
Total non-performing loans and other real estate owned to total assets	.04%	.03%

Management establishes reserves for losses on delinquent loans when it determines that losses are probable. The Company did not record a provision for general loan losses in fiscal 2003 or 2002 due to the overall performance of the loan portfolio and management's assessment of the overall adequacy of the allowance for loan losses. Although management believes that it uses the best information available to make determinations with respect to loan loss reserves, future adjustments to reserves may be necessary if economic conditions differ substantially from the assumptions used in making the initial determinations.

Residential mortgage lending generally entails a lower risk of default than other types of lending. Consumer loans and commercial real estate loans generally involve more risk of collectibility because of the type and nature of the collateral and, in certain cases, the absence of collateral. It is the Company's

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policy to establish specific reserves for losses on delinquent consumer loans and commercial loans when it determines that losses are probable. In addition, consumer loans are charged against reserves if they are more than 120 days delinquent unless a satisfactory repayment schedule is arranged. Although management has currently established no specific reserves for losses, no assurance can be given as to whether future specific reserves may be required. The establishment of any such reserves could affect net income.

The following table summarizes activity in the Company's allowance for loan losses during the periods indicated.

	Year Ended September 30,	
	-----	-----
	2003	2002
	-----	-----
Allowances at beginning of year	\$ 2,034,832	\$ 2,036,188
Provision for loan losses charged to operating expenses	--	--
Recoveries	--	5,113
Loans charged off	(44,160)	(6,469)

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	-----	-----
Allowances at end of year	\$ 1,990,672	\$ 2,034,832
	=====	=====
Ratio of net charge-offs to average loans outstanding	--	--
Ratio of allowances to period-end loans	.66%	.68%

Investment Activities

The Company is required to maintain certain liquidity ratios and does so by investing in securities that qualify as liquid assets under FDIC regulations. Such securities include obligations issued or fully guaranteed by the United States government, certain federal agency obligations, certain time deposits and certificates of deposit as well as other specified investments. See "Regulation - Federal Home Loan Bank System."

The Company's investment portfolio consists primarily of United States Treasury securities and obligations of United States government agencies. The other investments include interest-bearing deposits in other banks, tax-exempt obligations, ARM mutual funds, and stock of the FHLB of Pittsburgh. The Company has primarily invested in instruments that reprice within five years; the amount of such investments as of September 30, 2003 was \$263.1 million.

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The following table sets forth the Company's investment portfolio at carrying value as of the dates indicated.

	As of September 30,		
	2003	2002	2001
	-----	-----	-----
	(In Thousands)		
Interest-bearing deposits at other depository institutions	\$ 4,836	\$ 34,872	\$ 7,588
Tax-exempt obligations	25,290	24,881	23,771
ARM mutual funds	3,812	12,000	3,294
Equities	1,061	--	--
U.S. Government and agency obligations held to maturity	58,036	30,784	38,431
FHLB of Pittsburgh stock	13,782	10,497	8,950
Total	-----	-----	-----
	\$106,817	\$113,034	\$ 82,034
	=====	=====	=====

The Company's investment strategy is set and reviewed periodically by the entire Board of Directors.

Sources of Funds

General. Deposits are the primary source of the Company's funds for use in lending and for other general business purposes. In addition to deposits, the Company obtains funds from loan payments and prepayments, FHLB advances and other borrowings, and, to a lesser extent, sales of loans. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows are significantly influenced by general market interest rates and economic conditions.

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60 month	39,495	10.4	34,257	9.2	18,607
Other	8,988	2.4	5,268	1.4	3,712
Retirement accounts:					
Money market deposit accounts	1,242	0.3	902	0.2	559
Certificates of deposit	44,954	11.8	42,354	11.4	36,686
Total deposits	<u>\$380,687</u>	<u>100.0%</u>	<u>\$371,947</u>	<u>100.0%</u>	<u>\$350,147</u>

The large variety of deposit accounts offered by the Company has increased the Company's ability to retain deposits and has allowed it to be competitive in obtaining new funds, although the threat of disintermediation (the flow of funds away from savings institutions into direct investment vehicles such as government and corporate securities and non-deposit products) still exists. The new types of accounts; however, have been more costly than traditional accounts during periods of high interest rates. In addition,

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the Company has become more vulnerable to short-term fluctuations in deposit flows as customers have become more rate-conscious and willing to move funds into higher yielding accounts. The ability of the Company to attract and retain deposits and the Company's cost of funds have been, and will continue to be, significantly affected by money market conditions.

The following table presents certain information concerning the Company's deposit accounts as of September 30, 2003 and the scheduled quarterly maturities of its certificates of deposit.

	Amount	Percentage of Total Deposits	Weighted Average Nominal Rate
	-----	-----	-----
	(Dollars in Thousands)		
Passbook and club accounts	\$ 4,028	1.1%	0.66%
NOW accounts	17,340	4.6	0.15
Checking accounts	10,047	2.6	0.18
Money market deposits accounts(1)	96,970	25.5	1.02
Total	<u>\$128,385</u>	<u>33.7%</u>	<u>0.82%</u>
Certificate accounts maturing by quarter:			
December 31, 2003	\$ 38,645	10.2	2.45
March 31, 2004	34,470	9.1	2.67
June 30, 2004	23,263	6.1	2.71
September 30, 2004	26,203	6.9	3.24
December 31, 2004	18,718	4.9	3.00
March 31, 2005	13,062	3.4	2.72
June 30, 2005	6,188	1.6	3.57
September 30, 2005	5,617	1.5	3.12
December 31, 2005	4,142	1.1	4.74
March 31, 2006	3,082	0.8	4.51

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June 30, 2006	5,921	1.6	4.36
September 30, 2006	16,986	4.5	4.26
Thereafter	56,005	14.7	3.98
	-----	-----	-----
Total certificate accounts(1)	252,302	66.3	3.25
	-----	-----	-----
Total deposits	\$380,687	100.0%	2.43%
	=====	=====	=====

(1) Includes retirement accounts.

Management of the Company expects, based on historical experience and its pricing policies, to retain a significant portion of the \$122.6 million of certificates of deposit which mature during the 12 months ended September 30, 2004.

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The following table sets forth the net deposit flows of the Company during the periods indicated.

	Year Ended September 30	
	2003	2002
	-----	-----
	(In Thousands)	
(Decrease)/increase before interest credited	\$ (9)	\$11,241
Interest credited	8,749	10,559
	-----	-----
Net deposit increase	\$ 8,740	\$21,800
	=====	=====

The following table presents by various interest rate categories the amounts of certificate accounts as of the dates indicated and the amounts of certificate accounts as of September 30, 2003 which mature during the periods indicated.

	Amounts at September 30, 2003 Maturing				
	As of September 30, 2003	One Year or Less	Two Years	Three Years	Thereafter
	-----	-----	-----	-----	-----
	(In Thousands)				
Certificate accounts:					
0.01% to 2.00%	\$ 60,468	\$ 46,970	\$ 13,254	\$ 244	\$
2.01% to 4.00%	119,876	58,886	22,385	8,732	2
4.01% to 6.00%	65,974	14,089	7,187	18,574	2
6.01% to 8.00%	5,984	2,636	759	2,581	

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	Year Ended September 30,		
	2003	2002	2001
	(Dollars in Thousands)		
Advances from FHLB of Pittsburgh:			
Average balance outstanding	\$ 4,496	\$ --	\$ 5,222
Maximum amount outstanding at any month-end during the period	18,500	1,900	16,200
Weighted average interest rate during the period	1.20%	2.08%	6.31%

Competition

The Company faces significant competition in attracting deposits. Its most direct competition for deposits has historically come from commercial banks and other savings institutions located in its market

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area. The Company faces additional significant competition for investors' funds from other financial intermediaries. The Company competes for deposits principally by offering depositors a variety of deposit programs, convenient branch locations, hours and other services. The Company does not rely upon any individual group or entity for a material portion of its deposits.

The Company's competition for real estate loans comes principally from mortgage banking companies, other savings institutions, commercial banks and credit unions. The Bank competes for loan originations primarily through the interest rates and loan fees it charges, the efficiency and quality of services it provides borrowers, referrals from real estate brokers and builders, and the variety of its products. Factors which affect competition include the general and local economic conditions, current interest rate levels and volatility in the mortgage markets.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") eliminated many of the distinctions between commercial banks and savings institutions and holding companies and allowed bank holding companies to acquire savings institutions. FIRREA has generally resulted in an increase in the competition encountered by savings institutions and has resulted in a decrease in both the number of savings institutions and the aggregate size of the savings industry.

Employees

The Company had 54 full-time employees and 41 part-time employees as of September 30, 2003. None of these employees is represented by a collective bargaining agent, and the Company believes that it enjoys good relations with its personnel.

Regulation

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The references to laws and regulations which are applicable to the Company and the Bank set forth below and elsewhere herein are brief summaries thereof which do not purport to be complete and are qualified in their entirety by reference to such laws and regulations.

On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act (the "1999 Act") which repealed Depression-era laws that generally separated the business of banking from other financial services including the business of insurance and securities. From time to time other bills may be introduced in the United States Congress which could result in additional or in less regulation of the business of the Company and the Bank. It cannot be predicted at this time whether any such legislation actually will be adopted or how such adoption would affect the business of the Company or the Bank.

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Regulation of the Company

General. The Company is a registered bank holding company pursuant to the Bank Holding Company Act ("BHCA") and, as such, is subject to regulation and supervision by the Federal Reserve Board and the Department. The Company is required to file annually a report of its operations with, and will be subject to examination by, the Federal Reserve Board and the Department.

BHCA Activities and Other Limitations. The BHCA prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank, or increasing such ownership or control of any bank, without prior approval of the Federal Reserve Board. The BHCA also generally prohibits a bank holding company from acquiring any bank located outside of the state in which the existing bank subsidiaries of the bank holding company are located unless specifically authorized by applicable state law. No approval under the BHCA is required; however, for a bank holding company already lawfully owning or controlling 50% of the voting shares of a bank to acquire additional shares of such bank.

The BHCA also prohibits a bank holding company, with certain exceptions, from acquiring more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than banking or managing or controlling banks. Under the BHCA, the Federal Reserve Board is authorized to approve the ownership of shares by a bank holding company in any company, the activities of which the Federal Reserve Board has determined to be so closely related to banking or to managing or controlling banks as to be a proper incident thereto. In making such determinations, the Federal Reserve Board is required to weigh the expected benefit to the public, such as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The 1999 Act permits a bank holding company to elect to be considered a financial holding company ("FHC"). A bank holding company that makes an FHC election is permitted to engage in activities that are financial in nature or incidental to such financial activities. The 1999 Act lists certain activities that are considered financial in nature and permits the Federal Reserve Board to expand that list to include other activities that are complementary to the activities on the preapproved list. The preapproved activities include (1) securities underwriting, dealing and market making; (2) insurance underwriting; (3) merchant banking; and (4) insurance company portfolio investments. The Company has not made the financial holding company election.

The Federal Reserve Board has by regulation determined that certain

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activities are closely related to banking within the meaning of the BHCA. These activities include operating a mortgage company, finance company, credit card company, factoring company, trust company or savings association; performing certain data processing operations; providing limited securities brokerage services; acting as an investment or financial advisor; acting as an insurance agent for certain types of credit-related insurance; leasing personal property on a full-payout, non-operating basis; providing tax planning and preparation

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services; operating a collection agency; and providing certain courier services. The Federal Reserve Board also has determined that certain other activities, including real estate brokerage and syndication, land development, property management and underwriting of life insurance not related to credit transactions, are not closely related to banking and a proper incident thereto. However, under the 1999 Act certain of these activities are permissible for a bank holding company that becomes an FHC.

Limitations on Transactions with Affiliates. Transactions between savings institutions and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a savings institution is any company or entity which controls, is controlled by or is under common control with the savings institution. In a holding company context, the parent holding company of a savings institution (such as the Company) and any companies which are controlled by such parent holding company are affiliates of the savings institution. Generally, Sections 23A and 23B (i) limit the extent to which the savings institution or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such institution's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus and (ii) require that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and other similar transactions. In addition to the restrictions imposed by Sections 23A and 23B, no savings institution may (i) loan or otherwise extend credit to an affiliate, except for any affiliate which engages only in activities which are permissible for bank holding companies, or (ii) purchase or invest in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the savings institution.

In addition, Sections 22(h) and (g) of the Federal Reserve Act places restrictions on loans to executive officers, directors and principal stockholders. Under Section 22(h), loans to a director, an executive officer and to a greater than 10% stockholder of a savings institution, and certain affiliated interests of either, may not exceed, together with all other outstanding loans to such person and affiliated interests, the savings institution's loans to one borrower limit (generally equal to 15% of the institution's unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons and also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a savings institution to all insiders cannot exceed the institution's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers.

Capital Requirements. The Federal Reserve Board has adopted capital adequacy guidelines pursuant to which it assesses the adequacy of capital in examining and supervising a bank holding company and in analyzing applications

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to it under the BHCA. The Federal Reserve Board capital adequacy guidelines generally require bank holding companies to maintain total capital equal to 8% of total risk-adjusted assets, with at least one-half of that amount consisting of Tier I or core capital and up to one-half of that amount consisting of Tier II or supplementary capital. Tier I capital for bank holding companies

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generally consists of the sum of common stockholders' equity and perpetual preferred stock (subject in the case of the latter to limitations on the kind and amount of such stocks which may be included as Tier I capital), less goodwill and, with certain exceptions, intangibles. Tier II capital generally consists of hybrid capital instruments; perpetual preferred stock which is not eligible to be included as Tier I capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no additional capital) for assets such as cash to 100% for the bulk of assets which are typically held by a bank holding company, including multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Single-family residential first mortgage loans which are not past-due (90 days or more) or non-performing and which have been made in accordance with prudent underwriting standards are assigned a 50% level in the risk-weighting system, as are certain privately-issued mortgage-backed securities representing indirect ownership of such loans. Off-balance sheet items also are adjusted to take into account certain risk characteristics.

In addition to the risk-based capital requirements, the Federal Reserve Board requires bank holding companies to maintain a minimum leverage capital ratio of Tier I capital to total assets of 3.0%. Total assets for this purpose does not include goodwill and any other intangible assets and investments that the Federal Reserve Board determines should be deducted from Tier I capital. The Federal Reserve Board has announced that the 3.0% Tier I leverage capital ratio requirement is the minimum for the top-rated bank holding companies without any supervisory, financial or operational weaknesses or deficiencies or those which are not experiencing or anticipating significant growth. Other bank holding companies will be expected to maintain Tier I leverage capital ratios of at least 4.0% to 5.0% or more, depending on their overall condition.

Financial Support of Affiliated Institutions. Under Federal Reserve Board policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances when it might not do so absent such policy. The Congress attempted to clarify the application of this "source-of-strength" doctrine by an amendment to Section 18 of the Federal Deposit Insurance Act ("FDIA") that was included in the Gramm-Leach-Bliley Act of 1999. The amendment describes the circumstances under which a Federal banking agency would be protected from a claim by an affiliate or a controlling shareholder of an insured depository institution seeking the return of assets of such an affiliate or controlling shareholder. Under the amended provision, a claim would not be permitted if (1) the insured depository institution was under a written Federal directive to raise capital, (2) the institution was undercapitalized, and (3) the subject Federal banking agency followed the procedures set forth in Section 5(g) of the BHCA.

Sarbanes-Oxley Act of 2002. On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002 implementing legislative reforms intended to address corporate and accounting fraud. In addition to the establishment of a new accounting oversight board which will enforce auditing, quality control and independence standards and will be funded by fees from all publicly traded companies, the bill

restricts provision of both auditing and consulting services by accounting firms. To ensure auditor independence, any non-audit services being provided to an audit client will require preapproval by the company's audit committee members. In addition, the audit partners must be rotated. The bill requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the SEC, subject to civil and criminal penalties if they knowingly or willfully violate this certification requirement. In addition, under the Act, counsel will be required to report evidence of a material violation of the securities laws or a breach of fiduciary duty by a company to its chief executive officer or its chief legal officer, and, if such officer does not appropriately respond, to report such evidence to the audit committee or other similar committee of the board of directors or the board itself.

Longer prison terms will also be applied to corporate executives who violate federal securities laws, the period during which certain types of suits can be brought against a company or its officers has been extended, and bonuses issued to top executives prior to restatement of a company's financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from insider trading during retirement plan "blackout" periods, and loans to company executives are restricted. In addition, a provision directs that civil penalties levied by the SEC as a result of any judicial or administrative action under the Act be deposited to a fund for the benefit of harmed investors. The Federal Accounts for Investor Restitution ("FAIR") provision also requires the SEC to develop methods of improving collection rates. The legislation accelerates the time frame for disclosures by public companies, as they must immediately disclose any material changes in their financial condition or operations. Directors and executive officers must also provide information for most changes in ownership in a company's securities within two business days of the change.

The Act also increases the oversight of, and codifies certain requirements relating to audit committees of public companies and how they interact with the company's "registered public accounting firm" ("RPAF"). Audit committee members must be independent and are barred from accepting consulting, advisory or other compensatory fees from the issuer. In addition, companies must disclose whether at least one member of the committee is a "financial expert" (as such term will be defined by the SEC) and if not, why not. Under the Act, a RPAF is prohibited from performing statutorily mandated audit services for a company if such company's chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions has been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date. The Act also prohibits any officer or director of a company or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate or mislead any independent public or certified accountant engaged in the audit of the company's financial statements for the purpose of rendering the financial statement's materially misleading. The Act also requires the SEC to prescribe rules requiring inclusion of an internal control report and assessment by management in the annual report to shareholders. The Act requires the RPAF that issues the audit report to attest to and report on management's assessment of the company's internal controls. In addition, the Act requires that each financial report required to be prepared in accordance with (or reconciled to) accounting principles generally accepted in the United

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States of America and filed with the SEC reflect all material correcting adjustments that are identified by a RPAF in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the SEC.

Regulation of the Bank

General. The Bank is subject to extensive regulation and examination by the Department and by the FDIC, which insures its deposits to the maximum extent permitted by law. The federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for certain loans. There are periodic examinations by the Department and the FDIC to test the Bank's compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Department, the FDIC or the Congress could have a material adverse impact on the Bank and their operations.

Pennsylvania Savings Bank Law. The Pennsylvania Banking Code of 1965, as amended (the "Banking Code") contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, employees and members, as well as corporate powers, savings and investment operations and other aspects of the Bank and its affairs. The Banking Code delegates extensive rulemaking power and administrative discretion to the Department so that the supervision and regulation of state-chartered savings banks may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

One of the purposes of the Banking Code is to provide savings banks with the opportunity to be competitive with each other and with other financial institutions existing under other Pennsylvania laws and other state, federal and foreign laws. A Pennsylvania savings bank may locate or change the location of its principal place of business and establish an office anywhere in Pennsylvania, with the prior approval of the Department.

The Department generally examines each savings bank not less frequently than once every two years. Although the Department may accept the examinations and reports of the FDIC in lieu of the Department's examination, the present practice is for the Department to conduct individual examinations. The Department may order any savings bank to discontinue any violation of law or unsafe or unsound business practice and may direct any trustee, officer, attorney or employee of a savings bank engaged in

an objectionable activity, after the Department has ordered the activity to be terminated, to show cause at a hearing before the Department why such person should not be removed.

Interstate Acquisitions. The Interstate Banking Act allows federal regulators to approve mergers between adequately capitalized banks from

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different states regardless of whether the transaction is prohibited under any state law, unless one of the banks' home states has enacted a law expressly prohibiting out-of-state mergers before June 1997. This act also allows a state to permit out-of-state banks to establish and operate new branches in this state. The Commonwealth of Pennsylvania has "opted in" to this interstate merger provision. Therefore, the prior requirement that interstate acquisitions would only be permitted when another state had "reciprocal" legislation that allowed acquisitions by Pennsylvania-based bank holding companies has been eliminated. The new Pennsylvania legislation, however, retained the requirement that an acquisition of a Pennsylvania institution by a Pennsylvania or a non-Pennsylvania-based holding company must be approved by the Banking Department.

FDIC Insurance Premiums. The deposits of the Bank are insured by the SAIF, which is administered by the FDIC. Under current FDIC regulations, SAIF-insured institutions are assigned to one of three capital groups which are based solely on the level of an institution's capital. SAIF assessment rates are then tied to the level of an institution's supervisory concern based on risk classifications derived from the capital groups. Rates during the last six months of 2003 ranged from zero for well capitalized, healthy institutions, such as the Bank, to 27 basis points for undercapitalized institutions with substantial supervisory concerns.

In addition, all institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, a mixed-ownership government corporation established to recapitalize the predecessor to the SAIF. The assessment rate for the third quarter of 2003 was 0.016% of insured deposits and is adjusted quarterly. These assessments will continue until the Financing Corporation bonds mature in 2019.

Under the FDIA, insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged or is engaging in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or written agreement entered into with the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance. At September 30, 2003, the Bank's regulatory capital exceeded all of its capital requirements.

Capital Requirements. The FDIC has promulgated regulations and adopted a statement of policy regarding the capital adequacy of state-chartered banks which, like the Bank, are not members of the Federal Reserve System. The FDIC's capital regulations establish a minimum 3.0% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 to 200 basis points for all other state-chartered, non-member banks, which

effectively will increase the minimum Tier I leverage ratio for such other banks to 4.0% to 5.0% or more. Under the FDIC's regulation, highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System. Leverage or core capital is defined as the sum of common stockholders' equity (including retained earnings), noncumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain qualifying supervisory goodwill, and certain purchased

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mortgage servicing rights and purchased credit and relationships.

The FDIC also requires that savings banks meet a risk-based capital standard. The risk-based capital standard for savings banks requires the maintenance of total capital which is defined as Tier I capital and supplementary (Tier 2 capital) to risk weighted assets of 8%. In determining the amount of risk-weighted assets, all assets, plus certain off balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset or item.

The components of Tier I capital are equivalent to those discussed above under the 3% leverage standard. The components of supplementary (Tier 2) capital include certain perpetual preferred stock, certain mandatory convertible securities, certain subordinated debt and intermediate preferred stock and general allowances for loan losses. Allowance for loan losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital. At September 30, 2003, the Bank met each of its capital requirements.

A bank which has less than the minimum leverage capital requirement shall, within 60 days of the date as of which it fails to comply with such requirement, submit to its FDIC regional director for review and approval a reasonable plan describing the means and timing by which the bank shall achieve its minimum leverage capital requirement. A bank which fails to file such plan with the FDIC is deemed to be operating in an unsafe and unsound manner, and could subject the bank to a cease-and-desist order from the FDIC. The FDIC's regulation also provides that any insured depository institution with a ratio of Tier I capital to total assets that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the FDIA and is subject to potential termination of deposit insurance. However, such an institution will not be subject to an enforcement proceeding thereunder solely on account of its capital ratios if it has entered into and is in compliance with a written agreement with the FDIC to increase its Tier I leverage capital ratio to such level as the FDIC deems appropriate and to take such other action as may be necessary for the institution to be operated in a safe and sound manner. The FDIC capital regulation also provides, among other things, for the issuance by the FDIC or its designee(s) of a capital directive, which is a final order issued to a bank that fails to maintain minimum capital to restore its capital to the minimum leverage capital requirement within a specified time period. Such directive is enforceable in the same manner as a final cease-and-desist order.

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The Bank is also subject to more stringent Department capital guidelines. Although not adopted in regulation form, the Department utilizes capital standards requiring a minimum of 6% leverage capital and 10% risk-based capital. The components of leverage and risk-based capital are substantially the same as those defined by the FDIC.

Loans-to-One Borrower Limitation. Under federal regulations, with certain limited exceptions, a Pennsylvania chartered savings bank may lend to a single or related group of borrowers on an "unsecured" basis an amount equal to 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if such loan is secured by readily-marketable collateral, which is defined to include certain securities and bullion, but generally does not include real estate.

Activities and Investments of Insured State-Chartered Banks. Section 24 of the FDIA, as amended by the Federal Deposit Insurance Corporation Improvement

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Act of 1991, generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

The FDIC has adopted final regulations pertaining to the other activity restrictions imposed upon insured savings banks and their subsidiaries by Section 24. Pursuant to such regulations, insured savings banks engaging in impermissible activities may seek approval from the FDIC to continue such activities. Savings banks not engaging in such activities but that desire to engage in otherwise impermissible activities may apply for approval from the FDIC to do so; however, if such bank fails to meet the minimum capital requirements or the activities present a significant risk to the FDIC insurance funds, such application will not be approved by the FDIC. The FDIC has authorized the bank's subsidiary HARL, LLC, to invest up to 15% of its capital in the equity securities of bank holding companies, banks or thrifts. \$1.1 million was invested in HARL, LLC as of September 30, 2003.

Regulatory Enforcement Authority. FIRREA included substantial enhancement to the enforcement powers available to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In

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general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. FIRREA significantly increased the amount of and grounds for civil money penalties and requires, except under certain circumstances, public disclosure of final enforcement actions by the federal banking agencies.

Federal and State Taxation

General. The Bank is subject to federal income taxation in the same general manner as other corporations with some exceptions, including particularly the reserve for bad debts discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to the Bank.

Method of Accounting. For federal income tax purposes, the Bank currently reports its income and expenses on the accrual method of accounting and uses a tax year ending September 30 for filing its federal income tax returns.

Allowance for Loan Losses. As of January 1, 1996, the Company changed its

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method of computing reserves for bad debts to the experience method. The bad debt deduction allowable under this method is available to small banks with assets less than \$500 million. Beginning October 1, 2000, the Company changed its method of computing reserves for bad debts to the specific charge-off method. The bad debt deduction allowable under this method is available to large banks with assets greater than \$500 million. Generally, this method allows the Company to deduct an annual addition to the reserve for bad debts equal to its net charge-offs.

A thrift institution required to change its method of computing reserves for bad debts to the experience method treats such change as a change in method of accounting determined solely with respect to the "applicable excess reserves" of the institutions. The amount of applicable excess reserves is taken into account ratably over a six taxable-year period, beginning with the first taxable year beginning after December 31, 1995. For financial reporting purposes, the Company has not incurred any additional tax expense. Amounts that had been previously deferred will be reversed for financial reporting purposes and will be included in the income tax return of the Company, increasing income tax payable. The change from the experience method to the specific charge-off method in the current year will not result in a recapture of bad debt reserves for tax purposes. Retained earnings at September 30, 2003 and 2002 included approximately \$1,325,000 representing bad debt deductions for which no deferred income taxes have been provided.

Distributions. If the Bank distributes cash or property to its stockholders, and the distribution is treated as being from its accumulated pre-1988 tax bad debt reserves, the distribution will cause the Bank to have additional taxable income. A distribution to stockholders is deemed to have been made from

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accumulated bad debt reserves to the extent that (a) the reserves exceed the amount that would have been accumulated on the basis of actual loss experience, and (b) the distribution is a "non-dividend distribution." A distribution in respect of stock is a non-dividend distribution to the extent that, for federal income tax purposes, (i) it is in redemption of shares, (ii) it is pursuant to a liquidation of the institution, or (iii) in the case of a current distribution, together with all other such distributions during the taxable year, it exceeds the Bank's current and post-1951 accumulated earnings and profits. The amount of additional taxable income created by a non-dividend distribution is an amount that when reduced by the tax attributable to it is equal to the amount of the distribution.

Minimum Tax. The Code imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI"). The alternative minimum tax is payable to the extent such AMTI is in excess of an exemption amount. The Code provides that an item of tax preference is the excess of the bad debt deduction allowable for a taxable year pursuant to the percentage of taxable income method over the amount allowable under the experience method. The other items of tax preference that constitute AMTI include (a) tax exempt interest on newly-issued (generally, issued on or after August 8, 1986) private activity bonds other than certain qualified bonds and (b) for taxable years beginning after 1989, 75% of the excess (if any) of (i) adjusted current earnings as defined in the Code, over (ii) AMTI (determined without regard to this preference and prior to reduction by net operating losses). Net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years.

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Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding three taxable years and forward to the succeeding 15 taxable years. Effective for net operating losses arising in tax years beginning after October 1, 1997, the carryback period is reduced from three years to two years and the carryforward period is extended from 15 years to 20 years. At September 30, 2003, the Bank had no net operating loss carryforwards for federal income tax purposes.

Corporate Dividends-Received Deduction. The corporate dividends-received deduction is 80% in the case of dividends received from corporations with which a corporate recipient does not file a consolidated tax return, and corporations which own less than 20% of the stock of a corporation distributing a dividend may deduct only 70% of dividends received or accrued on their behalf. However, a corporation may deduct 100% of dividends from a member of the same affiliated group of corporations.

Other Matters. The Company's federal income tax returns for its tax years 1993 and beyond are open under the statute of limitations and are subject to review by the Internal Revenue Service ("IRS").

Pennsylvania Taxation. The Bank is subject to tax under the Pennsylvania Mutual Thrift Institutions Tax Act, which imposes a tax at the rate of 11.5% on the Bank's net earnings, determined in accordance with accounting principles generally accepted in the United States of America, as shown on

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its books. For fiscal years beginning in 1983, and thereafter, net operating losses may be carried forward and allowed as a deduction for three succeeding years. This Act exempts the Bank from all other corporate taxes imposed by Pennsylvania for state tax purposes, and from all local taxes imposed by political subdivisions thereof, except taxes on real estate and real estate transfers.

Subsidiary

The Bank is the only direct wholly owned subsidiary of the Company. The Bank formed HSB, Inc., a Delaware company, as a wholly owned subsidiary of the Bank during fiscal 1997. HSB, Inc. was formed in order to accommodate the transfer of certain assets that are legal investments for the Bank and to provide for a greater degree of protection to claims of creditors. The laws of the State of Delaware and the court system create a more favorable environment for the proposed business affairs of the subsidiary. HSB, Inc. currently manages the investment securities for the Bank, which as of September 30, 2003 amounted to approximately \$131.4 million. The Bank formed two limited liability companies in 2002, Freedom Financial Solutions LLC ("FFS") and HARL LLC ("HARL"). FFS was established to engage in the sale of insurance products through a third party. HARL was established for the purpose of investing in FDIC insured financial institutions/holding company equity securities.

Item 2. Properties.

As of September 30, 2003, the Company conducted its business from its main office in Harleysville, Pennsylvania and five other full service branch offices. The Company is also part of the STAR ATM System, which provides customers with access to their deposits at locations worldwide.

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County	Address	Owned or Leased	Lease Expiration Date	of Property Leasehold Improvements September 30, 2003
Montgomery	271 Main Street Harleysville, Pennsylvania	Owned	--	\$ 1,191
Montgomery	640 East Main Street Lansdale, Pennsylvania	Leased	May 2043 (1)	984
Montgomery	1550 Hatfield Valley Road Hatfield, Pennsylvania	Leased	January 2064 (1)	911
Montgomery	2301 West Main Street Norristown, Pennsylvania	Owned	--	616
Montgomery	3090 Main Street Sumneytown, Pennsylvania	Owned	--	372
			Total	\$ 4,074

(1) The land at this office is leased; however, the Bank owns the building.

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Item 3. Legal Proceedings.

The Company is not involved in any legal proceedings except nonmaterial litigation incidental to the ordinary course of business.

Item 4. Submission of Matters to a Vote of Security Holders.

Not Applicable.

PART II

Item 5. Market for the Company's Common Stock and Related Stockholder Matters.

The information required herein is incorporated by reference from page 27 of the Company's 2003 Annual Report to Stockholders ("Annual Report") and from Part III, Item 12 hereof.

Item 6. Selected Financial Data.

The information required herein is incorporated by reference from page 1 of the Annual Report.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The information required herein is incorporated by reference from pages 4 to 8 of the Annual Report.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information required herein is incorporated by reference from pages 6 to 8 of the Annual Report.

Item 8. Financial Statements and Supplementary Data.

The information required herein is incorporated by reference from pages 10 to 26 of the Annual Report.

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Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

Not Applicable.

Item 9A. Controls and Procedures.

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of September 30, 2003. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) occurred during the fourth fiscal quarter of fiscal 2003 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART III

Item 10. Directors and Executive Officers of the Company.

The information required by Items 401 and 405 of Regulation S-K with respect to directors and executive officers of the Company is incorporated by reference from the information contained in the section captioned "Information with Respect to Nominees for Director, Directors Whose Terms Continue and Executive Officers" in the Company's definitive Proxy Statement for the Annual Meeting of Stockholders to be held January 28, 2004 (the "Proxy Statement"), a copy of which will be filed with the Securities and Exchange Commission before the meeting date.

The Company has adopted a Code of Conduct and Ethics that applies to its principal executive officer and principal financial officer, as well as other officers and employees of the Company and the Bank. A copy of the Code of Ethics, included as an exhibit to this Form 10-K and filed with the Securities and Exchange Commission, may also be found on the Company's website at www.harleysvillesavingsbank.com.

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Item 11. Executive Compensation.

The information required by Item 11 of Form 10-K is incorporated by reference from the information contained in the section captioned "Management Compensation" in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by Item 403 of Regulation S-K is incorporated by reference from the information contained in the section captioned "Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management" in the Proxy Statement.

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Equity Compensation Plan Information. The following table sets forth certain information for all equity compensation plans and individual compensation arrangements (whether with employees or non-employees, such as directors), in effect as of September 30, 2003.

Plan Category	Number of Shares to be issued upon the Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options
Equity Compensation Plans Approved by Security Holders	125,881	\$14.99
Equity Compensation Plans Not Approved by Security Holders	--	--
Total	125,881 =====	\$14.99 =====

Item 13. Certain Relationships and Related Transactions.

The information required by Item 13 of Form 10-K is incorporated by reference from the information contained in the section captioned "Management Compensation - Indebtedness of Management" in the Proxy Statement.

Item 14. Principal Accounting Fees and Services.

Not applicable.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) Contents

1. The following financial statements are incorporated by reference from Item 8 hereof (see Exhibit 13):

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Independent Auditors' Report

Consolidated Statements of Financial Condition as of September 30, 2003
and 2002

Consolidated Statements of Income for the Years Ended September 30, 2003,
2002 and 2001

Consolidated Statements of Stockholders' Equity for the Years Ended
September 30, 2003, 2002 and 2001

Consolidated Statements of Cash Flows for the Years Ended
September 30, 2003, 2002 and 2001

Notes to Consolidated Financial Statements

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2. All schedules are omitted because they are not required or applicable, or the required information is shown in the consolidated financial statements or the notes thereto.

(b) Reports on Form 8-K

The Company filed a Form 8-K on July 17, 2003, furnishing a press release announcing its results of operations for the quarter ended June 30, 2003, which is required by Item 12 of Form 8-K, and was provided under Item 9 pursuant to Commission Release 34-47583.

(c) Exhibits

The following exhibits are filed as part of this Form 10-K and this list includes the Exhibit Index.

No.	Exhibits	Lo
3.1	Articles of Incorporation	
3.2	Bylaws	
4	Common Stock Certificate	
10.1	1995 Employee Stock Purchase Plan*	Filed
10.2	1995 Stock Option Plan*	Filed
10.3	2000 Stock Option Plan*	
10.4	Profit Sharing Incentive Plan*	Filed
10.5	Employment Agreements with Edward J. Molnar, Ronald B. Geib, and Marian Bickerstaff*	
13	Annual Report to Stockholders	Filed
22	Subsidiaries of the Registrant - Reference is made to "Item 1. Business - Subsidiaries" of this Form 10-K for the required information	
23	Consent of Deloitte & Touche	Filed
31.1	Certification of Chief Executive Officer	Filed
31.2	Certification of Chief Financial Officer	Filed
32.1	Section 1350 Certification of the Chief Executive Officer	Filed
32.2	Section 1350 Certification of the Chief Financial Officer	Filed
99	Code of Conduct and Ethics	Filed

* Denotes management compensation plan or arrangement

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- (1) Incorporated herein by reference to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission ("SEC") on February 25, 2000.
- (2) Incorporated by reference to the Company's definitive proxy statement dated December 19, 2000 filed with the SEC.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

HARLEYSVILLE SAVINGS
FINANCIAL CORPORATION

December 19, 2003

By: /s/ Edward J. Molnar

Edward J. Molnar
Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

/s/ Edward J. Molnar

December 19, 2003

Edward J. Molnar
Chief Executive Officer
and Director
(principal executive officer)

/s/ Brendan J. McGill

December 19, 2003

Brendan J. McGill
Senior Vice President, Treasurer
and Chief Financial Officer
(principal financial and principal
accounting officer)

/s/ Sanford L. Alderfer

December 19, 2003

Sanford L. Alderfer
Director

/s/ Paul W. Barndt

December 19, 2003

Paul W. Barndt
Director

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/s/ Philip A. Clemens

December 19, 2003

Philip A. Clemens
Director

/s/ Mark R. Cummins

December 19, 2003

Mark R. Cummins
Director

/s/ David J. Friesen

December 19, 2003

David J. Friesen
Director

/s/ Ronald B. Geib

December 19, 2003

Ronald B. Geib
Director, President and
Chief Operating Officer

/s/ George W. Meschter

December 19, 2003

George W. Meschter
Director